

UNITED STATES SENTENCING COMMISSION

*Public Hearing on Organizational Sanctions
United States Court of Appeals - Pasadena, California*

Friday, December 2, 1988

9 a.m.	Judge William W. Wilkins, Jr., Chairman Opening Remarks
9:05 - 9:25	Paul Thomson Deputy Assistant Administrator for Criminal Enforcement Environmental Protection Agency
9:30 - 9:50	Arthur N. Levine Deputy Chief Counsel for Litigation, Food and Drug Administration
9:55 - 10:15	Jan Chatten-Brown Special Assistant to the District Attorney, Los Angeles County
10:20 - 10:40	Robert M. Latta Chief U.S. Probation Officer, Central District of California
10:45 - 11:05	Robert A.G. Monks President, Institutional Shareholders Services
11:10 - 11:30	Christopher Stone Professor, University of Southern California Law Center
11:35 - 11:55	Richard Gruner Associate Professor, Whittier College School of Law
	<i>LUNCH</i>
1:30 - 1:50	Charles B. Renfrew Vice President, Chevron
1:55 - 2:15	Jerome Wilkenfeld Health, Environment & Safety Department, Occidental Petroleum
2:20 - 2:40	Bruce Hochman, Esq. Hochman, Salkin & DeRoy, Beverly Hills, CA
2:45 - 3:05	Ivan P'ng Assistant Professor, University of California School of Management
	Eric Zolt Acting Professor of Law, UCLA School of Law
3:10 - 3:30	Maygene Giari Citizens United for the Reform of Errants (CURE)

Board of Directors

Don Taylor
Chairperson
Donna Leone Hamm
Vice Chairperson
M. [redacted]
S. [redacted]
Jim Austin
Cindy Scaglione
Don H. Weaver
Ted West
Mary Wathen White
Lois A. Williamson

Advisors

Al Bronstein
Maygene Giari
Daniel Johnson
Alan Pogue
Milton G. Rector
Edgardo Rotman
Diann Y. Rust-Tierney
William Bennett Turner
Henry Scott Wallace

Chapters

Alabama
District of Columbia
Massachusetts
Michigan
Ohio
Pennsylvania
South Dakota
Texas
Virginia

Contact Chapters

Colorado, Iowa,
Maine, Minnesota,
Mississippi, Nevada,
North Dakota, Nebraska,
Oklahoma, South Carolina,
West Virginia

Affiliates

Charities, Diocese
Washington (Delaware)
Families of Incarcerated:
Support and Services
(Rochester, NY)
Families and Friends of
Persons in Prison (Missouri)
Families of Prisoners Coalition
(Maryland)
Inside-Out: Citizens United for
Prison Reform, Inc.
(Connecticut)
Justice Ministry/Lutheran
Social Services of Illinois
Middle Ground (Arizona)
Oregon People for
Prison Alternatives
New York State Coalition
for Criminal Justice, Inc.
Rhode Island Justice Alliance
Very Special Persons (Indiana)

Public Official Sponsors

Sen. Quentin N. Burdick
Sen. John F. Kerry
Cong. Daniel K. Akaka
Cong. Jim Bates
Cong. Howard L. Berman
Cong. John Bryant
Cong. Albert G. Bustamante
Cong. William L. Clay
Cong. Ronald D. Coleman
Cong. John Conyers, Jr.
Cong. Ronald V. Dellums
Cong. Mervyn M. Dymally
Cong. Lane Evans
Cong. Martin Frost
Cong. Robert Garcia
Cong. William H. Gray III
Cong. Charles A. Hayes
Cong. William Lehman
Cong. Mickey Leland
Cong. John Lewis
Cong. Charles B. Rangel
Cong. Louise M. Slaughter
Cong. Harley O. Staggers, Jr.



**Executive Director
and Administrator**
Charles and Pauline Sullivan
National Office:
11 15th St. NE #8
Washington, DC 20002
Phone: 202-543-8399

CITIZENS UNITED FOR REHABILITATION OF ERRANTS
"A National Effort to Reduce Crime Through Criminal Justice Reform"

November 18, 1988

Comments Regarding
Discussion Materials on
Organizational Sanctions

For: Testimony before the Sentencing Commission
December 2, 1988, Pasadena, California

By: Maygene Giari
1015 Nithsdale Road
Pasadena, CA 91105
Tel. 818 449-2498

I am a member of and advisor to CURE, Citizens United for the Rehabilitation of Errants. My interest in criminal justice grew out of my initially reluctant participation in a League of Women Voters' study of Oklahoma's prison system. The league believes in informed citizen participation in government; the first workshop I attended made me realize how badly misinformed I had been about the effectiveness of the criminal justice system.

A graduate of the Columbia University School of Library Science, with experience both as a research librarian and as a researcher, I have been studying the criminal justice system for fifteen years. Realizing that much of the public is probably as badly misinformed as I had been, I am incorporating my findings in a book, "The Same Wrong Roads": A Concerned Citizen Looks at the Criminal Justice System.

I appreciate the time and effort that has gone into the preparation of the discussion materials on organizational sanctions. Sentencing is an enormously complex problem. The focus of my testimony is on the question,

Should Organizational Sanctions
Be Based on Past Sentencing Practices?

The Sentencing Commission earlier expressed concern about the public perception of a double standard of justice, one for the affluent and influential and another for everyone else. This perception results from the disparity in penalties between organizational offenses and those for blue-collar offenses. Past sentencing practices are the cause of the belief in a double standard of justice. Use of those practices as the basis for organizational sanctions in any way could only perpetuate public skepticism about equality of justice.

Specific examples of unequal justice include the minimal sanctions imposed on organizational offenders; the failure to prosecute responsible decision-makers, and/or the lenient penalties imposed when they are prosecuted; and the priority given to prosecution of economic offenses rather than to regulatory violations that affect the public health and safety. Granted, the dollar value of economic crimes is enormous. But an important, major function of government is the protection of its citizens. Such protection should include practices that threaten consumer and worker safety, life, and health.

Only a thorough revision of present sentencing practices can restore public faith in the equality of justice. Many of the features in the discussion materials could go far toward achieving that end. The potential for achieving a single standard of justice, however, is dependent upon which of the proposals in the discussion materials are adopted.

Restitution. The emphasis placed on victim restitution/compensation wherever feasible is a commendable departure from present sentencing practices. As the report on federal sentencing of organizations between 1984 and 1987 indicates, remedies for the harm done by the offense have been infrequent.

Coordinating compensatory remedies through administrative or civil enforcement. The even greater emphasis given to coordinating remedies, however, raises serious questions. The "Commentary" in the draft guidelines does mention that the court should "consider whether the alternative compensation would be materially more burdensome or costly for victims to obtain than restitution under the criminal system, or would be delayed inordinately beyond the time that criminal restitution would be received." And the Deputy Chief Counsel suggests that possibly collateral remedies could be ignored, perhaps with the right to petition for modification if such remedies are invoked. But nowhere else are such possibilities mentioned.

On the contrary: the frequent mention both by Mr. Parker and in the draft guidelines, that civil remedies are more likely to be available, practicable, less costly, and less difficult to enforce, strongly suggest a preference for these remedies. Other comments to the effect that civil or administrative enforcement actions far outnumber criminal prosecutions against organizations further suggest that this type of action is considered preferable to criminal prosecution.

Administrative enforcement actions by regulatory agencies have often been minimal in some of the most serious cases involving product- and worker-safety and other health- and life-threatening situations. Or they have been long delayed, coming only after a number of non-governmental civil injury suits have been filed or even settled. Such administrative inaction--not the infrequency of violations--may well be the reason why the report on sentencing practices showed a relatively small percentage of federal prosecutions and sentencings for environmental and health and safety regulations.

Inadequacy of administrative actions. When administrative actions have been taken, too often they have been inadequate in terms of the harm caused.

The sanctions imposed on organizations and their responsible officers for policies that have caused a number of deaths, injuries, and serious illnesses are in no way comparable to the penalties imposed on the blue-collar offender who commits only one such offense. An example is the fines imposed on Eli Lilly Research Laboratories and one of its former officials in the arthritis drug Oraflex case.

A possible remedy. As long as the regulatory agencies continue to be dilatory in their enforcement of regulatory violations, the "government's interest in achieving regulatory objectives" is unlikely to be achieved. One of the powers given the Sentencing Commission, however, was to "make recommendations to Congress concerning modification or enactment of statutes" that "the Commission finds to be necessary and advisable to carry out an effective . . . sentencing policy." This is an area where the Sentencing Commission might well consider a recommendation to Congress for a modification of statutes to encourage more effective regulatory enforcement.

Civil litigation puts the burden of enforcement on citizens instead of on government--but nowhere is government enforcement more appropriate than in life- or health-threatening situations. Moreover, civil injury suits are likely to result in inadequate compensation for harm. As the American Bar Association material points out, many victims lack the resources to pursue legal remedies, or may not be aware of their rights. Victims may be forced to accept a settlement that unfairly reflects the strength of their case; the pressure to settle is often strongest on those who have been the most injured and who can least afford the delay of a civil suit.

Notice to victims and criminal restitution ordered by the sentencing court in every case where restitution is feasible would not only avoid unwarranted duplication of effort resulting from litigation in many courts. It would also promote greater efficiency and consistency in remedying harms. The sentencing

court would already have the facts of the case without need to review them. Because of the time that generally elapses before hearing civil suits, criminal restitution would usually provide quicker relief than civil suits. Since personal injury suits for food and drug violations, unlike other regulatory violations, are available only under state laws, not federal, these policies would be especially beneficial to victims of violations of those regulations.

Another way to coordinate compensatory remedies. The American Bar Association's proposal to limit recovery only to verifiable pecuniary losses is desirable. In the event that criminal restitution does not provide full compensation, victims could still bring personal injury suits. Double recovery would be avoided, as the ABA suggests, by considering criminal restitution as "the offender's down payment on eventual total liability."

Probation. The former requirement that another sentence must be suspended in order to impose a sentence to probation obviously did little to further public confidence in equality of justice. Nor did allowing the organization a choice between probation and the maximum penalty. Blue-collar offenders are not afforded comparable opportunities.

Organizational probation as a supplement to monetary penalties. The objectives of organizational probation proposed in the discussion draft are highly desirable for each type of probation. Ensuring compliance with notice to victims; ensuring compliance with monetary penalties; and preventive probation providing both the means and the incentive for the organization to strengthen its own internal controls and/or to carry out remedial measures are all worthy goals.

Preventive probation. The warning that the application of preventive probation is "subjective and must be approached with caution" is puzzling. The conditions for imposing preventive probation enumerated in the draft proposal for this sanction are quite clear. The court should have no difficulty

in determining whether an offense resulted in loss of human life; threatened public health or safety; was repetitive; involved management policies that encouraged, facilitated, or otherwise contributed to the offense or delayed its detection; or the involvement of senior management was not clear.

Determination of whether the organization has corrected the policies or practices sufficiently to make repetition unlikely may be somewhat difficult in the case of economic crimes. However, when the offense has involved danger to the public health and safety (such as the improper disposal of toxic chemicals, suppression of design-safety defects, or sale and promotion of products known to be carcinogenic), such violations are obvious, and adequate correction to prevent recurrences is imperative. Such harms are so serious that preventive probation monitored by experts would surely be warranted to prevent repetition of the offense.

Direct supervision by the court, of course, is unacceptable. The court cannot reasonably be expected to have either the time or the expertise needed for such supervision.

Preventive probation as unwarranted interference with the free enterprise system. The concern that "Direct government intervention is likely to harm the economy" assumes that the greatest possible "social loss" is economic harm. This assumption minimizes the importance of human life, health, and safety. Our remote ancestors are reputed to have considered human sacrifice necessary to produce good crops. Civilization has not advanced very far if human sacrifice is considered necessary to promote a flourishing economy.

Preventive probation can be administered without interference in legitimate business activity. Combining the conditions and terms included in the draft guidelines with the equally comprehensive proposals in the discussion draft on organizational probation would provide adequate protection for legitimate business activities.

Costs of compliance may exceed total fine authorized is mentioned several times in the discussion materials. If this were the case, it would be inadequate justification for failure to enforce compliance costs. Rather, it would indicate that the level of fines is too low.

Specific departure considerations incomplete. The policy statement in the draft guidelines authorizes an upward departure "If the offense resulted in a foreseeable and substantial risk of serious bodily injury or death." Combined with the "Part K - Departures" of the sentencing guidelines, these policies apparently limit upward departures to deaths or serious bodily injuries resulting from violations of environmental, food, drug, biologic, medical device, cosmetic, or agricultural products.

In the sentencing guidelines, on the other hand, the offenses involved in "tampering" and "providing false information or threatening to tamper with consumer products" also include "any article, product, or commodity produced or distributed for consumption by individuals." This more inclusive definition is needed for organizations as well.

The draft guidelines include no specific reference to death or injuries resulting from defective or hazardous consumer products such as vehicles, tires, appliances, clothing. Nor is any specific reference made to ultimately fatal illnesses such as brown lung, silicosis, cancer, or asbestos-related diseases resulting from exposure to harmful substances in the workplace--illness that develops only many years after such exposure.

The departures authorized by "passage of time" also include no reference to fatal illness occurring long after the regulatory violation has been knowingly risked. Indeed, the discussion of a "societal" discount rate might even be interpreted to mean that a reduction of the expected risk would be acceptable if that risk becomes apparent only after an extended period of time.

Additional departures should be authorized for organizational sentencing --departures even more comprehensive than the "tampering" sections of the sentencing guidelines. Reliable estimates are available, both for the risks involved in defective or hazardous consumer products, and for the incidence of fatal illness to be anticipated from workplace exposure to harmful substances. Such estimates are by no means "subjective." They warrant upward departures to provide adequate victim compensation. Specific "passage of time" provisions should also be included to adequately cover the belated development of fatal illness resulting from the hazardous workplace.

The importance of preventive probation. Finally, preventive probation as a supplementary sentence could do more to restore public confidence in equality of justice than any other sanction. The explanation of Professors Coffee, Gruner, and Stone of why this would be true cannot be improved upon:

In the public's eye, a precisely calibrated system of fines may be perceived as amounting to a tariff system that permits corporations and other business entities to engage in criminal behavior so long as they are prepared to pay the specified tax.* Ultimately, the aim . . . is to prevent the prohibited behavior, not simply raise the cost of engaging in it . . . It is particularly important to communicate clearly that [the] effort to price the crime does not legitimize it. Organizational probation, as a supplementary sentence, makes clear that there is no price that, when paid, entitles the organization to engage in the misbehavior. (Italics added.)

*Quite possibly, many organizations also share this view.

Punishment is costly as well as beneficial. The social costs of punishment can outweigh its benefits. Enforcement and punishment are also uncertain.

The Deputy Chief Counsel's many reiterations of the above principles are eloquent and convincing. These principles were not even considered in the preparation of the Sentencing Guidelines and Policy Statements.



Testimony of
Arthur N. Levine
Deputy Chief Counsel for Litigation
United States Food and Drug Administration¹

Before

The United States Sentencing Commission

on

Discussion Materials on Organizational Sanctions

^{1/} The views expressed in this paper are solely those of the author and do not represent the policy or views of the FDA.

My name is Arthur Levine. I have been an attorney in the General Counsel's Office of the Food and Drug Administration for 18 years and currently serve as the Deputy Chief Counsel for Litigation. I have general supervisory responsibility over FDA litigation, particularly enforcement litigation prepared by the agency and referred by our office to the Department of Justice for filing.

The FDA is a science-based, law enforcement organization which implements its regulatory programs through a wide variety of administrative and judicial sanctions. The vast majority of FDA referrals for criminal prosecution include charges against both business organizations and the individuals responsible for the conduct resulting in the offense. Criminal prosecutions initiated at the request of the FDA include not only violations of the Federal Food, Drug, and Cosmetic Act (FDCA) and provisions of the Public Health Service Act, but also violations of the federal criminal code, including most frequently false statements, mail and wire fraud, obstruction, and conspiracy.

Until passage of the Criminal Fines Enforcement Act of 1984 significantly enhanced the monetary sanctions for violations of federal law, the maximum fines for violations of the FDCA, which had not been increased since 1938, were very small -- \$1,000 for each misdemeanor offense and \$10,000

for each felony offense. Under current law, 18 U.S.C. 3571,² the maximum fines applicable to organizations range from \$200,000 per offense for a misdemeanor to \$500,000 per offense for a felony or, in the alternative, not more than twice the gross gain derived from or twice the gross loss caused by the offense.

The Sentencing Commission's Discussion Draft of Sentencing Guidelines and Policy Statement for Organizations outlines an approach for determining an appropriate fine within the current maximums. In establishing a formula to compute such fines, the Commission has been guided by the Sentencing Reform Act which, among other things, directs that a criminal sentence should provide just punishment, afford adequate deterrence and protect the public from further crimes of the defendant. A sentence should also reflect the seriousness of the offense and promote respect for the law. 18 U.S.C. 3553(a).

The approach selected by the Commission is structured around five available sentencing options for organizations: three types of monetary sanctions --¹ restitution, ² forfeitures, and ³ fines; and two types of non-monetary sanctions -- ⁴ notice to victims and ⁵ probation. The Commission has observed that monetary sanctions "have the most direct impact on business firms' fundamental

^{2/} The Criminal Fine Improvements Act of 1987 (Pub. L. 100-185, December 11, 1987).

interest."³ The draft guidelines seek to "rationalize the determination of the monetary sanctions by reference to sentencing factors concerning the loss caused by the offense, the detectability of the offense, and the enforcement costs incurred in the investigation, prosecution, and punishment of the offender."⁴ This loss-based approach is designed to provide organizations "with measured incentives for assuring their compliance with federal law, in a manner that is both proportionate to the harmful potential of offenses and conducive to the objective of criminal control."⁵ Under the Commission's draft guideline, the total monetary sanction is determined by multiplying a calculation of loss caused by the offense times a "multiple" which is designed to reflect the difficulty of detecting and punishing the offender, adding enforcement costs and then "coordinating" the total monetary sanction with non-criminal sanctions already or simultaneously imposed. Loss guidelines are established for seven specified categories of criminal conduct.

My review of the Commission's draft guideline begins with the question of selecting the applicable loss guideline pursuant to which base loss will be computed. Given the variety of criminal conduct within the jurisdiction of the

3/ Discussion Draft of Sentencing Guidelines, July 1988 (Draft Guideline), 8.1.

4/ Id.

5/ Id., at 8.2.

FDA, the selection of the loss guideline, though an initial step, is not necessarily an easy or obvious one. Indeed, of the seven specified-loss guidelines into which the Commission has divided all organizational offenses, violations of the FDCA are directly addressed in three -- private fraud, food, drug, and agriculture offenses, and regulatory reporting offenses -- and some offenses under the Act (counterfeiting, diversion, and illegal importation) are referenced in a fourth -- theft, commercial infringement, embezzlement, receipt of stolen property, and property destruction. While the existence of overlapping guideline categories is not inherently undesirable and may be necessary, the applicability of more than a majority of the designated loss guidelines to offenses within the jurisdiction of one federal regulatory agency will no doubt lead to considerable debate between prosecutors and the defense bar and may lead to inconsistent application of sentencing standards in different jurisdictions and between individual judges.

Selection of the applicable guideline and its consequences: My reading of the loss guidelines and their commentaries revealed certain consequences that the Commission may not have intended and which seemed at odds with the Commission's apparent objective that sanctions for

health and safety statutes provide a higher loss figure than would be obtained under guidelines a substantive offense.⁶

Cost to fix + revenues = the base loss is computed by adding the reasonable costs of ameliorating the risk caused by the offense, plus "the net selling price of any contaminated or otherwise dangerous product that actually was sold". Section 8B2.6(a). Under this calculation, if a large amount of a dangerous product was actually sold, then the base loss would be substantial even if the costs of ameliorating the risk were low. However, because this guideline is based on product that was actually sold, prompt cessation of shipment due to intervening FDA regulatory action would put a significant cap on the base loss. If the offense did not involve a contaminated or dangerous product and did not "otherwise represent a substantial safety risk,"⁷ the private fraud loss guideline would apply. The base loss computation for private fraud measures the difference between the value paid and the value received, an amount which would often (but not always)

6/ "Loss guidelines for environmental and food and drug offenses involve statutes designed to prevent harms or risks of harms to health and safety that often are diffused and difficult to identify to specific victims. For this type of offense, the guidelines specify higher minimum loss amounts designed to recognize the risks inherent in this type of criminal conduct ..." Draft Guideline, 8.3.

7/ See Section 8B2.6(b)(1) and Commentary application note 2, Draft Guideline at 8.23.

be lower than the selling price,⁸ the measure used in the food, drug and agricultural guideline. However, the computation of base loss for private fraud is not restricted to the amount actually sold. Consistent with the general application instructions, Section 8B1.1, losses include those that were "reasonably certain to occur, but for the fact that the offense was not completed because of circumstances beyond the defendant's control". Calculation of loss under the private fraud guideline presumably would be based on all of the product intended for sale, not limited to that actually sold.⁹ Thus, at least where a relatively small amount of product is shipped, the organizational fine will be much higher for a mislabeled product, for which the private fraud loss guideline is applicable, than for a dangerous product, for which the food, drug, and agricultural offenses loss guideline is applicable.

The regulatory reporting offenses guideline: The regulatory reporting offenses guideline, Section 8B2.7, provides that if the offense "causes, contributes to, or conceals a substantive offense," then the guideline applicable to the substantive offense applies. Section 8B2.7(b)(1). However, the food, drug, and agricultural

8/ As the Commission has observed, the value of a fraudulent product in "many cases ... will be zero". Application note 2, Draft Guideline at 8.10.

9/ For offenses committed intentionally, recklessly or by criminal negligence, harm is computed with reference to all actual harm and all risk of harm. Section 8B1.1(a)(2).

offenses guideline provides that if the offense involved a recordkeeping or reporting violation "that neither resulted or is likely to result in any substantive harm to health or safety" then one should refer to the regulatory reporting offenses guideline. See Section 8B2.6(b)(2). Thus, the food, drug, and agricultural offenses guideline frames the decision about the applicable guideline in terms of the consequences of the reporting, whereas the regulatory reporting offenses guideline frames its own applicability in terms of the relationship of non-reporting to a substantive offense.

The commentary to the regulatory reporting offenses guideline states that this guideline applies to refusals to grant access to government inspectors when required by law. I found this limitation troublesome. Not only might such refusal constitute an obstruction of justice, a Title 18 felony, but a refusal by its nature will at least temporarily conceal any substantive offense that exists. Indeed, many refusals are designed specifically with that purpose -- to delay an FDA inspection long enough to eliminate the evidence of an offense. It seems that refusals to grant access, which are explicitly confined to the regulatory reporting offenses guideline should justify referral to a substantive guideline.

The entire category of regulatory reporting offenses can be extremely elusive. For example, drug companies have an

affirmative obligation to report to the FDA significant adverse reactions caused by drugs being considered for marketing in this country but which are not yet approved.

(Information constituting such adverse reactions might arise from use of the drug in another country or from investigational study of the drug in this country.) It is very difficult to predict the harm that might result from the failure to report those adverse reactions. FDA's awareness of that information might result in either a decision not to permit the marketing of the drug at all (because it is too dangerous) or to permit the drug to be marketed just as the agency would have done without that information (because similar information was known to the agency and has already been taken into account in approving the drug's labeling).

In sum, at least in the FDA context, it is difficult to identify a regulatory reporting offense that could not or should not be considered under a substantive guideline, where the base loss would be greater. Ultimately, the truly minor recordkeeping offenses that apparently were intended to be covered by the Commission in creating this guideline should be dealt with by the sound judgment of regulatory agencies and prosecutors, that is, by underlying decisions about prosecutorial merit and in the exercise of prosecutorial discretion not to seek criminal sanctions for "simple" recordkeeping offenses. Other recordkeeping and reporting offenses, more properly analyzed, should be treated as

criminal fraud or as substantive food and drug violations, as the criminal statutes now do.

Minimum loss amounts: In its General Statement of Subjects and Issues for Public Comment Regarding Organizational Sanctions, the Commission has asked to what extent, if any, the minimum loss amounts in the draft should be incorporated in the guidelines. Particularly because the Commission guidelines compute loss for all of the offense conduct, not restricted to loss for a particular count upon which conviction is based, I believe that the minimum amounts, set as they are between \$500 and \$2,000, should be deleted. They are too low and do not serve well as a comparative frame of reference. I expect that in many cases they will be so much less than loss computed under the guidelines, they are likely to create uncertainty among judges relying on objective monetary sanctions data.

According to the Commission draft guideline, these minimum loss levels reflect losses observed or fines actually imposed during the period 1984-87. No doubt, the food, drug, and agricultural guideline minimum of \$2,000 reflects the median fine actually imposed for such offenses as reported in some of the Commission data. However, as I noted earlier, statutory fine limits for FDCA offenses were very low for offenses committed before December 31, 1984. Moreover, most convictions obtained throughout 1985 to 1987 reflect offenses committed before 1985 and the sentences imposed were

restricted to the fine limits set in 1938. Convictions based on post-1984 offenses have been noticeably higher, often in excess of \$20,000.¹⁰

The detectability multiples: The next step in the calculation of an organizational sanction is to apply the offense multiple, which is designed by the Commission to reflect "the difficulty of detecting and prosecuting an offense" and "to assure that the total monetary sanction is set at a punitive level that will serve the sentencing purposes of deterrent and just punishment". Draft Guidelines, 8.3. It also appears that the characteristics affecting detectability reflect in part an effort by the Commission to deal with a number of intangibles in sanctions-setting and with the fact that for organizations the Commission has chosen to make no distinction between felonious and misdemeanor conduct.

As a general matter, I believe that the base multiples -- 2 for private fraud, 2.5 for everything else -- are much too low. If under economic theory monetary sanctions are measurements of motivating business organizations to act as if "crime doesn't pay", then a base multiple of two reflects

^{10/} These data on organizational fines can be provided to the Commission at its request. Moreover, the Commission's current data seems somewhat equivocal. While a \$2,000 median figure was obtained in one inquiry (along with a \$12,000 "average" fine), a mean of \$9,800 was obtained in another. See Report to the U.S. Sentencing Commission, Criminal Sanctions of Organizations in the Federal Courts, 1984-1987, Tables 6 and 8.

a likelihood of detection and prosecution of approximately 50 percent. An FDA routine inspection of any particular firm occurs at a rate of once every two years. Even under agency procedures for "follow-up" inspections of firms which, upon initial inspection, appeared to be engaging in conduct which might result in violations of the Act, inspection might be expected once in six months. On this basis alone I believe that a multiple reflecting a 50 percent chance of detectability is unrealistic.

Even if the Commission's proposed base multiples were appropriate as a starting point, the Commission's adjustment schedule for characteristics which materially increase the difficulty of detecting and prosecuting the offense is too low since the presence of those factors increase the multiple only by one. If an organization's senior management has actively participated in or knowingly encouraged the offense,¹¹ then they are doing exactly the opposite of establishing a corporate program to discourage violations and deter corporate agents and operatives. Such conduct suggests to me an assessment by the organization's responsible officials that their likelihood of detection is very, very small, in the area of 1-2 percent. Under an economic deterrence theory, the offense multiple in such a case would be 50 to 100.

¹¹/ Section 8B3.2(a)(1).

Similarly, efforts to bribe officials, disguise or falsify transactions, actively conceal facts, obstruct the administration of justice,¹² all signal an attitude of invulnerability which undermines the fundamental assumptions of "measured incentives" of deterrence; no effort at deterrence is going on whatsoever. To increase the multiple by only one in such situations seems unlikely to create an atmosphere of deterrence, does not provide just punishment, does not promote respect for law and does not reflect the seriousness of the offense. A multiple increase of only one in the light of such detectability characteristics, many of which are themselves Title 18 felony violations (false statements, obstruction, and similar federal offenses), does not seem to adequately balance the Commission's implicit decision not to distinguish between felony (intentional) and misdemeanor (strict liability, regulatory and minor) violations of law. It may be that higher detection multiples than now proposed may result in organizational monetary sanctions beyond what the Commission, believes are appropriate. If so, then I suggest that the solution is to describe the process of applying the multiples to account for

given that the multiples are too low, what would you suggest?

12/ See 8B3.2(a) generally.

corporate deterrence in such a way that unwarranted expectations are not created.¹³

In addition, the Commission provides that the base multiple can be decreased if characteristics which materially decrease the difficulty of detecting or prosecuting the offense are present. I have some difficulty accepting a decrease in the multiple where the offense is committed "by open and obvious conduct, that was not concealed or misrepresented". Section 8B3.2(b)(2). While it might reflect a valid economic theory to view an open and obvious violation as resulting in a reduction of potential liability, considerations in a more mundane world render this benefit difficult to appreciate. When I, as an FDA lawyer, think of cases involving food manufacturing or storage establishments in which the moment the FDA investigator enters the facility, he or she is immediately struck by the fact that the facility is inundated with rats and birds, it is difficult to accept that the company's criminal fine will be reduced from what it would have been had the investigator needed to look further to find the violative conditions.

facts only
only

I submit that detectability characteristics should only be considered to increase the multiple of an organizational

13/ The Commission has asked in its Subjects and Issues list, questions 10 and 11, whether multiple levels should be based on past (1984-1987) sentencing practice. For the reasons I have given earlier, at least for offenses under FDA's jurisdiction, I believe that they should not.

defendant. Evidence of good faith should be considered in evaluating the criminal liability and in determining the sentence of the individuals charged for the same conduct.

Computation of the fine -- set-offs from the calculated total monetary sanction. On the basis of the base loss computation, the multiple, and the enforcement costs, the total monetary sanction is established. See Section 8C1.1. The commentary notes that organizational fines are determined by subtracting from the total the amounts of restitution and other compensatory sanctions both expended and expected; the remaining dollar amount is the midpoint of a fine, with a range of plus or minus 20 percent. Not only the amounts of direct restitution but also the amounts of restitution "equivalents" imposed through civil or administrative proceedings are deducted from the total monetary sanction in calculating the organizational fine.¹⁴ The breadth of this off-the-top deduction is reflected in the guideline on restitution (compensation to victims), Section 8C2.1, which measures available civil or administrative

^{14/} As the Commission repeatedly observes, food and drug violations create risks to the public that are diffuse and adversely affects victims who are difficult to identify. For that reason, restitution has not been, and likely will not become, a major part of the organizational monetary sanction equation. However, in some product areas, such medical devices and radiation products, where the FDA product may be a large piece of medical equipment costing tens of thousands of dollars, and the purchasers are well known to the manufacturer or distributor, then restitution may be available and would significantly reduce the remaining fine.

remedies as "equivalent to" restitution. See Section 8C2.1(c).

The computation of organizational fines, as the remainder of the total monetary sanction, raises two concerns for me as a food and drug lawyer. First, the reference to civil or administrative remedies as equivalent to restitution, together with the departures and adjustments policy statement applicable to civil penalties, suggest that in a number of situations organizational fines in the food and drug area would not be very high. This is because FDA's first response to a determination that a product is adulterated or misbranded or is being sold without the appropriate FDA approval, is to make an investigation and promptly implement administrative and civil sanctions to interrupt or preclude the distribution of the product (or the continued manufacturing of the product) in order to protect the public. In addition, in anticipation of regulatory action many firms will "voluntarily" recall violative products. Accordingly, in a large number of FDA criminal referrals, well before the agency has even begun to consider possible criminal sanctions, there has already been a substantial amount of regulatory and compensatory relief.

Administrative or civil regulatory actions against a business organization no doubt cost money, sometimes a lot of money. Moreover, organizations do not want to be charged as criminals for violation of federal law. The avoidance of

such charges has a considerable economic value to the company and convictions adversely affect (from the company's view) subsequent civil tort liability. Thus, in recent years and particularly with larger companies, there has been a tendency for firms not only to act cooperatively in the context of a specific civil or administrative sanction, but indeed to come forth offering to undertake further remedies, often in the nature of product recalls, compensation, or internal corrective action plans in an effort to dissuade the government from filing criminal charges. These activities are also very costly.

Such business practices, positive though they are, create a distinct possibility that criminal fines, calculated under a system featuring numerous compensatory set-offs, will not give due weight to the uniquely criminal nature of the penalty. A criminal indictment reflects a decision that notwithstanding the burdensomeness of related costs, criminal sanctions are nevertheless warranted. The societal judgment that the costs of doing business are not an adequate penalty and that further punitive measures are appropriate has some minimum value that should be expressed. The Commission's taxing of enforcement costs against a defendant "represents additional societal costs caused by the offense, for which the offender should be accountable". Guidelines Draft, 8.4. I fully support adding those costs in determining monetary sanctions and recognize that taxing

those costs addresses to some extent my concern about non-criminal set-offs. However, the criminal fine portion of the total monetary sanction should reflect not only actual law enforcement costs but societal judgments. I would support a fines minimum appropriate to the seriousness of the offense. A fixed amount is not necessary. If the question of the non-criminal remedies set-off were clarified, perhaps by use of a set-off percentage reflecting the presence or absence of designated characteristics, such as whether a firm acted promptly and independently to remedy the offense or only acted after initial interest by a regulatory agency, then a minimizing of the set-off would naturally result. This issue might be a suitable place for the Commission to implement 18 U.S.C. 3572(a)(7) which provides for consideration of efforts to discipline the responsible individuals in setting an organizational fine.

In this regard, I believe that the departures and adjustments for consideration of collateral civil penalties and disabilities, and for consideration of penalties against organizational agents, Sections 8C5.5 and 8C5.6, should be clarified. Commentaries throughout the guideline strongly suggest that civil penalties will be a dollar-for-dollar write-off against the remaining criminal fine. However, the section on collateral civil penalties not only provides no guidelines for computation of the set-off but does not state directly that collateral civil penalties should be

considered. Rather it provides that they should be considered if they reflect "either unusual circumstances affecting their availability or imposition or some disproportion between the detectability of the offense and the combined effect of criminal sanctions and civil penalties or disabilities." In all candor, I was simply unable to grasp what this policy statement was designed to communicate to prosecutors and judges. Similarly, the policy statement for setting-off penalties against the responsible agents provides guidance only in the case of punitive monetary penalties incurred by such individuals.

It is extremely rare that the FDA will refer a case for criminal prosecution which charges only the corporate entity. Moreover, the agency routinely rejects plea bargain offers to drop individuals who have been charged with criminal offenses in exchange for a plea from the corporation. Accordingly, the existence of guidance in this area is very important to the FDA. I believe that any deduction or set-off in an organization's fine to reflect penalties incurred by the individuals responsible for the organization's offense should not be significant. For one thing, it may very well be that the individuals charged are no longer with the corporation, either at the time charges are brought or at the time of sentencing. There may not be a close coordination of interests between them and the organization defendant. I suggest that the Commission should

distinguish between large publicly-held corporations and closely-held corporations. Where the corporate entity is an economic alter ego for an individual, or where a corporation is closely held, a significant set-off of the individual's fine is warranted. For large corporations, where the individuals were simply doing the corporate will or where there was an absence of corporate policy which would have precluded their conduct, then a set-off should be small, if at all. Only where officers and employees of large corporations were engaging in conduct contrary to explicit corporate policy, implemented by reasonably sound corporate monitoring and auditing practices, should there be a significant set-off of their fines.¹⁵

Probation. The guidelines provide two forms of non-monetary organizational sanctions: notice to victims and probation. As the materials provided by the Commission make

^{15/} The Commission's departure (8B5.2) for organizational sanctions where the offense resulted in foreseeable and substantial risk of serious bodily injury or death is also difficult to assess. While no computation scheme for such expected loss is provided in the policy statement itself, the commentary suggests an approach that seems unlikely to result in a significant upward departure in all but the rarest case. Working from one of the examples given, if a firm produces a product that has a one in a hundred foreseeability of causing serious harm, and will result in injuries of \$100,000 for each product, the fines increase would be only \$1,000. There are a great many FDA-regulated products -- vaccines, medical devices such as pacemakers, prescription drugs -- for which a foreseeable defect rate of one in a hundred is very high, and injuries of approximately \$100,000 could be expected. A fine increase of \$1,000 (even \$1,000 per actual defective unit) seems disproportionate to such a rate of foreseeable injury.

clear, the experience of the federal courts in imposing probation on convicted organizations is very small; there is little empirical data. As a result, it is apparent that the Commission has decided to move cautiously in this area.

I believe that the Commission should be more receptive to organizational probation and adopt criteria justifying the imposition of organizational probation, and requirements for a compliance plan, more like those set forth in the Draft Proposal on Standards for Organizational Probation proffered by Professors Coffee, Gruner, and Stone. I subscribe to the professors' view that "there is no reason why a sentencing court, following a criminal conviction based upon proof beyond a reasonable doubt, should have less flexibility in the preventive restraints that it can impose than another federal court, which may grant an injunction in a civil action ... based upon a preponderance of evidence" Draft Proposal, p. 8. The general parameters of such injunctive controls are well established in FDA cases. Moreover, it has become increasingly common in the FDA area for a corporation to "conduct a detailed internal investigation ... resulting in a lengthy self study and improved internal controls.... In this light, corporate probation represents not a new departure, but a codification of existing practices and requirements coupled with a clearer judicial role to ensure the integrity of the process." Id., at 9.

I believe that the prerequisites in the draft guideline for a sentence of "preventive" probation, i.e. probation for purposes other than forcing the payment of fines, restitution or compensation, are too rigorous. See Section 8D2.1(c). It should not be necessary for a court to find that senior management of the organization participated in or encouraged the offense. Rather, I think the criteria suggested by the professors is more appropriate, namely, that "management policies or practices of the organization, including any inadequacies in its internal controls encouraged, facilitated, or otherwise substantially contributed to the criminal behavior or delayed its detection, and such policies or practices have not been corrected in a manner that makes repetition of the same or similar behavior highly unlikely". Id., at 10. I also suggest that the imposition of probation should not be limited to situations where senior management has a record of one or more felony convictions. Corporate managers who have been negligent and even reckless may not, under applicable case law, be charged with felony offenses. Prior misdemeanor offenses based upon such conduct, particularly in the public health and safety area, should be an adequate precondition. The requirement that the prior

conviction be a felony also does not give appropriate weight to the consequences of plea bargaining.¹⁶

While probation, like other non-monetary sanctions, cannot be scaled precisely to the offense and is therefore

16/ A few specific observations on the professors' Draft Proposal are provided in this note.

The compliance plan should make explicit reference not only to correcting inadequate policies and practices, but also to establishing systems reasonably calculated to prevent the recurrence of those and similar violations and to detect such violations. Moreover, the plan should identify, by general job description and duties, those persons in the organization responsible for its implementation.

The conditions of probation suggested by the professors do not authorize the court to require the dismissal or demotion of organizational personnel. However, under the compliance plan they outline, a special compliance officer could be designated with responsibility for supervising organizational activities. The existence of such a person and an increase in the firm's audit function in general may necessarily result in the demotion of present personnel. I would suggest that the absolute prohibition against such demotion be revised.

The compliance plan's provision for the adoption of formal corporate policies, such as standard operating procedures, will probably be of limited value unless there is also provision that the employees utilizing such manuals be trained (or retrained) in the new procedures.

The professors' Draft Proposal provides that the report of the special probation officer "may" be disclosed to the regulatory agency having a legitimate interest in the information only at the discretion of the sentencing court. I believe that the final probation report, the main component of which will be the proposed compliance plan, should be made available automatically to at least that federal regulatory agency having direct jurisdiction over the conduct at issue, which no doubt will be the agency which recommended the criminal prosecution in the first place. Confidentiality can be insured by use of a protective order.

indeterminate, it can be framed to directly parallel previous inadequate corporate policies that failed to deter or detect the offense. Moreover, I find it no less predictable than setting-off the various forms of compensatory conduct. As Mr. Parker notes, probation "strikes at the very heart of the competitive process." Even if true, corporate quality control procedures should not in every case be immune from government interference. In the area of public health and safety, where the governmental interest is pervasive, societal interests are high and the harms diffuse and difficult to calculate, some amount of government oversight may be warranted. This is particularly true when corporate management has not changed in light of the offense and where such managers engaged in conduct as delineated in the Commission's detectability characteristics for multiples.

I appreciate the invitation to address the Commission. Your task is as demanding as it is important. If there is any further contribution that you feel I might make, I would be pleased to do so.

Thank you.

Statement of Professor Richard S. Gruner

Associate Professor of Law
Whittier College School of Law

United States Sentencing Commission Hearing
United States Courthouse
Pasadena, California
12/2/88

I am appearing before the Commission today to describe some of the strengths and weaknesses of organizational probation as a sentence for corporate offenders and other convicted organizations. Organizational probation -- best analyzed as a category of sentence in which the sentencing court retains continuing control over some aspect of organizational activities -- has the potential as a sentencing tool to fill several serious gaps in current corporate and organizational sentencing strategies.

The "Proposed Standards For Organizational Probation" that I and my colleagues John C. Coffee, Jr., and Christopher S. Stone have developed are an attempt to realize some of this potential; they provide definite standards for determining when organizational probation sentences are warranted and what types of probation conditions should be imposed. Rather than focus on these standards alone, my testimony today will address the historical and authoritative underpinnings of organizational probation as a federal sentence, including some discussion of applications of organizational probation beyond those endorsed in

the above probation standards, but which the Commission may nonetheless wish to consider.

Specifically, I will address examples of how organizational probation has been used by federal courts in the past, the types of sentencing strategies that can be furthered by organizational probation, and limitations on organizational probation as that form of sentence is authorized under the Sentencing Reform Act. These and other topics related to organizational probation are covered in much greater detail in my forthcoming article "To Let the Punishment Fit the Organization: Sanctioning Corporate Offenders Through Corporate Probation" which will appear this winter in the American Journal of Criminal Law; a copy of this article is attached as an appendix to this testimony.

I. Past Uses of Organizational Probation By Federal Courts

Under the Federal Probation Act, organizational probation, although not recognized as a type of sentence of itself, was sometimes imposed through the suspension of another sentence. Organizational probation imposed in this way was used to reform convicted organizations, to administer organizational punishments other than fines and to create specific deterrents to subsequent criminal conduct by the organizational probationer.

A. Organization Reform

Perhaps the best known applications of organizational probation under the Federal Probation Act involved probation conditions requiring specific reforms in subsequent conduct by convicted organizations. For example, in United States v.

Atlantic Richfield Company, 465 F.2d 58 (7th Cir. 1972) ("ARCO"), a trial court required the defendant corporation to develop and implement improvements in its programs to control oil spillages at a particular plant; these probation terms were aimed at requiring the firm to reform practices that had already led to several illegal spills at that plant. While the particular probation terms imposed by the trial court were overturned on appeal as too vague, the appellate court in ARCO recognized the appropriateness of corporate probation terms requiring specific reforms by offenders.

Other courts used corporate probation to insure that criminal sentences, while not requiring specific reform steps, were at least not a barrier to corporate reform. For example, in United States v. Danilow Pastry, Co., 563 F. Supp. 1159 (S.D.N.Y. 1983), the sentencing court was concerned that it not impose so harsh a fine as punishment for the defendant firm that reform was precluded altogether by forcing the firm out of business. The court felt that failure of the firm would place the real economic burden of the punishment on innocent employees and shareholders; its solution was to substitute community service by the firm (at a level that did not preclude profitable corporate operations) for the fine the court otherwise would have imposed.

B. Adjusting Punishments

Organizational probation was also used by some sentencing courts as a means to set organizational punishments at just levels. Interestingly, organizational probation was used to

adjust punishment levels both upward and downward from those available through other sanctions.

Some courts used organizational probation as a less severe alternative to organizational fines by suspending payment of fines altogether if good corporate behavior was maintained for the period of probation. Others reduced corporate punishments by transforming the economic burden of corporate fines into a less embarrassing (and often less substantial) obligation to make charitable contributions as a condition of probation. This last practice was eventually condemned by several circuit courts as an abuse of the sentencing court's relatively limited discretion under the Federal Probation Act to direct the payment of a monetary sanction other than to the federal treasury. The practice was also criticized because it produced too little economic impact on sentenced firms to reflect the seriousness of their crimes, prevented public use of the amounts paid by the defendant firms, gave sentencing courts no standards for determining the proper amount of the contributions, ignored sentencing courts' poor ability to pick and choose among countless worthy charitable organizations that might receive mandated contributions, subjected the courts to unnecessary criticism over suspected favoritism in the selection of recipient charities, and created possible conflicts of interests for sentencing courts if contributions were solicited.

By contrast, several courts used corporate probation as a means to increase, not decrease, the harshness of corporate

sanctions beyond levels otherwise available. These courts imposed corporate probation terms requiring convicted firms or their executives to take actions that were particularly unpleasant or embarrassing, often in a manner symbolizing the criminal nature of the firm's conduct. The objective, as one court put it, was to ensure "corporate penance".

Thus, for example, a sentencing court required several bakery firms convicted of price fixing to give their products to charitable organizations for local redistribution, in part to draw public attention to the defendants' crimes. Another court required a corporate probationer to employ several former convicts, presumably as a symbolic means to emphasize to persons inside and outside the corporation the criminal nature of the firm's conduct. Although these measures may have furthered the reform of the affected firms by encouraging employees to reflect on their firms' crimes, these probation sanctions were also designed to impose a degree of corporate punishment that fines would not have, by attaching a public stigma to the corporate probationers and their personnel.

C. Deterrence

An additional goal of some corporate probation terms was to help deter subsequent crimes by the corporation through heightened penalties for repeat offenses. This was accomplished by making the avoidance of further criminal conduct a condition of a firm's probation; upon conviction for a further offense during the period of probation, the firm would risk both a

revocation of its probation -- usually with the consequent imposition of a harsh fine -- and an additional punishment for its further crime. Used this way, corporate probation "increased the stakes" and created greater deterrents against further crimes by corporate probationers than were applicable to other corporations.

II. Advantages of Probation As An Organizational Sanction

A. Direct Impact On Organizational Reform

Perhaps the most important advantage of organizational probation as a criminal sentence is its ability to require organizational offenders to develop and adopt specific measures to prevent repeat offenses, thereby having a direct impact on organizational reform. The probation sentencing process can force corporate executives to identify the particular organizational structures and practices that led to an offense and to develop meaningful changes in those corporate features to prevent a reoccurrence. Absent the impetus of corporate probation, the natural tendency of managers in many firms will be to pay whatever monetary sanctions are imposed for corporate crimes and to return their attention as quickly as possible to matters having a clearer relationship to firm profits.

Beyond just insuring that post-offense reforms are initially adopted by organizational offenders, organizational probation can help insure that those reforms are maintained throughout the probation period. This can be insured through a combination of probation terms identifying persons within corporate probationers

responsible for particular probation compliance tasks, requiring the preparation by the corporation of regular reports to a probation officer or sentencing court on key aspects of probation compliance, and providing for direct spot checks of probation compliance by probation officers visiting the corporate probationer. The knowledge that corporate operations may be reviewed under probation standards should provide not only a substantial incentive for compliance with those standards, but a strong disincentive for illegal actions in related corporate activities.

B. Activation of Accountability Mechanisms Within Defendant Organizations

Organizational probation can also serve a valuable reform function by strengthening accountability mechanisms already present in defendant organizations. For example, organizational probation might be used to give a corporate board (or corporate shareholders if an independent board is not present) a meaningful opportunity to serve as a check on corporate management following a corporate crime, by requiring that the board be given a report by outside counsel describing the sources of the offense in detail. In a similar vein, the role of an audit committee comprised of independent directors might be strengthened by probation terms requiring that those directors obtain increased reports on portions of corporate financial affairs that were previously handled in a criminal manner.

C. Imposing Organizational Punishments More Onerous and Less Transferable Than Fines

A further use of organizational probation -- advocated by some commentators and courts, but not authorized under the probation standards submitted to the Commission by my colleagues and me -- is to impose forms of organizational punishments that can be at once more onerous than a fine and less transferable from responsible corporate managers to relatively innocent parties like corporate employees or shareholders. For example, organizational probation conditions might be imposed requiring actions that detrimentally affect the reputation of firms or their executives. To the extent that those reputations are dearly held by key corporate personnel, such probation terms can impose punishment and deterrence greater than the economic hardship of corporate fines. Furthermore, since reputations are peculiarly personal or institutional, the hardship of such reputational sanctions would remain with the affected organization or executives, with little chance that their effect could be passed on to others -- for example, in the way the economic hardship of fines might be passed on to employees through lower wages or to shareholders through lower dividends.

Interestingly, a federal district court recently imposed just this type of penalty in a major price fixing case. In United States v. Allegheny Bottling Company, 1988 WL 98106 (E.D. Va. 1988), the district court noted that the maximum corporate fine for price fixing of \$1 million paled in comparison with the \$10 million to \$12 million in illegal profits the defendant had

obtained. It concluded that a further "imprisonment" of the corporation beyond the maximum fine was both statutorily authorized and warranted in this case to properly punish the firm and to deter like conduct by others. It initially sentenced the firm to three years of imprisonment (to be accomplished by placing the firm in the custody of a United States Marshall) and the maximum fine of \$1 million. However, it suspended the execution of this sentence on the condition that the firm comply with probation conditions requiring the payment of a \$950,000 fine and the performance of extensive public service by four corporate executives.

The public service required by these probation terms involved considerable hardship for both the firm and the affected executives. An officer or employee of comparable salary and stature to the corporation's President was required to perform forty hours of community service per week for two years, as was an additional executive at the Vice-Presidential level. Two more executives at the Vice-Presidential level were required to provide similar weekly totals of community service for a one year period. These service obligations were not imposed on named individuals, but were required to be performed by persons of the indicated employment level. In addition to being deprived of the affected executives' services, the defendant firm was required to provide the executives for the indicated service without compensation to the firm.

While the court's conclusion that corporations can be

imprisoned is inconsistent with extensive prior authority, the possible invalidity of this conclusion has no bearing on the propriety under the Sentencing Reform Act of the type of punitive probation terms imposed in Allegheny Bottling. Under the Act, there is no need to determine whether corporate imprisonment can be imposed in addition to a maximum fine as a preliminary to a suspension of such imprisonment in favor of punitive probation conditions. Whether or not corporate "imprisonment" is authorized, the Sentencing Reform Act clearly permits courts to impose corporate probation terms in addition to a maximum fine.

The probation standards proposal currently before the Commission does not authorize this type of purely punitive corporate probation, largely because of the difficult punishment scaling problems and the potential unfairness to unconvicted individuals inherent in the use of punitive probation terms requiring public service; the proposal does authorize probation terms requiring community service by convicted firms where such service is a preferable substitute for restitution orders. However, in light of cases like Allegheny Bottling, the desirability of allowing sentencing courts to impose punitive probation terms as alternatives or supplements to corporate fines may deserve reconsideration by the Commission. It should be noted that changes in maximum corporate fines under the Criminal Fines Improvement Act may make this question less important, since the specific sentencing dilemma of an inadequate maximum fine encountered in Allegheny Bottling should be rarer. Were the

defendant in Allegheny Bottling sentenced under current fine standards, it could receive a fine of up to twice its illegal gains (i.e., a maximum fine of as much as \$24 million), which, assuming it could pay such a large sum, would obviate the need for punitive probation terms or other judicial restraints to achieve a proper level of corporate punishment and deterrence.

III. Limitations On Organizational Probation Under The Act

Appropriate probation conditions for organizations are limited by several features of the Sentencing Reform Act and by a number of judicial doctrines developed under prior law that should be carried forward in the interpretation of the Act. These are summarized below.

A. Statutory Limitations

1. Reasonableness

The Act requires that discretionary probation terms bear a reasonable relationship to the nature and circumstances of the probationer's offense, the history and characteristics of the probationer, and the four general goals of sentencing under the Act. Under prior law, courts developed similar reasonableness requirements for probation terms generally, with the reasonableness of particular probation conditions measured in light of factors like the degree of offender reform they promoted, the extent to which the conditions curtailed the exercise of normally available constitutional rights, and the impact of the conditions on law enforcement. The reasonableness of probation terms under the new Act will presumably depend on

similar factors, with some adjustment for the broader set of probation goals allowed under the new law.

Beyond recognizing the importance of these factors, the reasonableness test for probation terms under the new Act can be translated into several more specific concerns. One basic requirement is that discretionary probation conditions reflect a rational sentencing strategy under which one or more of the sentencing goals specified in the Act may be furthered by compliance with the terms. Probation conditions that fail to meet this test of minimal rationality will reflect no more than the personal interests or sentencing theories of individual judges; such arbitrary limitations on organizational conduct must certainly be treated as unreasonable probation constraints and, hence, unauthorized.

More importantly, the reasonableness test suggests that there must be some proportionality between the onus of organizational probation terms on the one hand and the seriousness of the defendant's offense on the other. This is implicit in the portions of the legislative history of the Act that recognize organizational managers as preferred decision-makers for their organizations, except where criminal behavior evidences a weakness in their decision making behavior. The range of acceptable probation burdens under this notion of proportionality would increase with the presence of factors like the following:

- (1) substantial social harm was inflicted or threatened by the defendant's offense and, by implication, the social harms that can be prevented through probation are similarly significant;
- (2) the defendant firm's assets or size will undercut the punitive effect of fines or other monetary sanctions;
- (3) the involvement of top management in illegal activities suggests that internal reform may not occur without probation requirements;
- (4) the compartmentalization of firm management has facilitated past illegal behavior in particular operating units;
- (5) the defendant firm has failed to take its own steps to study the sources of its offense and to implement preventative reforms; or
- (6) the offender's crimes involved concealment or numerous small injuries to victims causing the offenses to go undetected for a substantial period and future crimes of the same character are likely to go similarly undetected absent probation monitoring mechanisms.

2. Special Standards For Deprivations of Property or Liberty -- Applicability to Organizational Probation

The Act further requires that deprivations of liberty or property under probation conditions must meet special standards -- i.e., these probation conditions must be reasonably necessary

to achieve one of the general sentencing goals under the Act. This reasonable necessity standard suggests that courts have an obligation to consider the efficacy of less restrictive probation terms in achieving sentencing goals before imposing probation terms requiring a deprivation of property or liberty.

Probation terms requiring a deprivation of property will presumably raise similar issues when applied to individual and organizational probationers. Examples of such terms requiring reasonable necessity would include terms calling for deferred payment of a fine, restitution, or other monetary transfer. However, the mere fact that probation terms requiring specific organizational conduct will lead to some organizational compliance expenditures should not be taken to imply that these terms deprive the probationer of property within the meaning of these probation tests. Were this the case, almost every probation limitation (on either organizations or individuals) would trigger the higher scrutiny of the reasonable necessity test because compliance with most probation terms is inconvenient or expensive.

The other component of the reasonable necessity test concerning deprivations of liberty may have limited applicability to organizational probationers. The legislative history of the Act suggests that these provisions were designed to protect against arbitrary probation conditions requiring individual defendants to undergo limited forms of incarceration through arrangements such as weekend custody or required residence at a

drug rehabilitation facility. The obvious focus was a desire to limit individual freedom of action only to the extent necessary to serve sentencing goals. Where organizations are involved, such personal freedom is not at stake; therefore, the higher standards for authorizing probation limitations on liberty should probably never be applied to probation conditions for organizational defendants.

B. Judicial Limitations Drawn From Prior Law

1. Specificity

One judicially recognized limitation on organizational probation terms under prior law that should probably be carried over in interpreting the new Act is the requirement that probation terms be sufficiently unambiguous that both the organizational probationer and others administering the probation (such as probation officers) can distinguish between probation compliance and violation. Clear and specific probation conditions are desirable for a number of reasons. First, in light of the potentially harsh consequences of violating probation terms, fairness requires that probationers have clear notice of when a violation is occurring. Second, where, as will often be the case in organizational contexts, probation compliance requires long-term efforts by probationers, specific probation compliance standards will facilitate the types of planning necessary for such long-term efforts to be carried out effectively. Third, requiring that sentencing courts define probation terms in detail insures that they, and not probation

officers, will define the content of probation limitations on offenders. Fourth, specific probation terms will be easier and more efficient to administer in the probation monitoring process than ambiguously stated probation terms. Finally, by establishing a definite standard for sufficient probationer conduct, detailed probation terms can help prevent and reveal oppressive conduct by overreaching probation officers.

2. Probation Compliance Costs

Another limitation on organizational probation conditions developed under prior law was the notion that probation compliance costs should not exceed the level of maximum fines for the same offense. Several courts concluded that this limit stemmed from their lack of constitutional authority to impose punishments in any form that exceed the maximum penalties specified for offenses by Congress.

Under the Sentencing Reform Act, however, Congress provided for organizational probation sentences in addition to a sentence to a maximum fine. This may suggest that Congress intended that probation restrictions be used to raise penalties for organizational offenders beyond the levels available through maximum fines; under this approach, penalties under probation terms would be a corporate substitute for the harsher penalties imposed on individuals through incarceration, similar to the way corporate probation was used by the court in Allegheny Bottling. Alternatively, the provision for organizational probation in addition to a maximum fine may suggest that such probation is

only appropriate in this situation where it is used for purposes other than punishment, such as probation terms designed to insure organizational reform or to promote restitution to crime victims. Under this approach, maximum fines would be viewed as an indicia of maximum authorized penalties, but further burdens on organizational offenders for sentencing purposes like reform or restitution would always be deemed to be within the sentencing court's authority. This latter interpretation probably is preferable insofar as it places some meaningful limits on organizational penalties; at the same time, it recognizes that penalties, offender reforms, and victim restitution are independent sentencing goals under the new Act such that a sentence which furthers one of these goals to maximum extent possible does not preclude additional sentence components that further other goals.

V. Conclusion

The probation provisions of the Sentencing Reform Act of 1984 authorize an important new sentencing tool for organizational offenders. These provisions authorize probation sentences that can be flexibly tailored to the individual circumstances of organizational offenders and their crimes. This in turn means that probation sanctions can impose organizational penalties that are particularly potent and organizational reforms that change the particular standards and processes which led to the offense. Furthermore, since the effectiveness of probation penalties and reforms do not depend on the precise measurement of

social losses or offender gains implicit in an organizational offense nor upon the translation of those loss or gain figures into a meaningful monetary sanction, reliance on probation sentences avoids much of the technical complexity and risk of inadequate sanctions involved in a system relying on precisely measured and targeted monetary sanctions like that proposed in the Commission Staff's Discussion Draft. Because of these advantages, organizational probation deserves the Commission's detailed attention in developing guidelines for organizational sentencing.

In a case like Allegheny, what would provide greater deterrence to the public + other corps

- 1) a fine of 2x the gains (24 million)
- 2) $\frac{1}{2}$ fine (12 mill) and $\frac{1}{2}$ probation - including the intense comm. service

THE UNITED STATES SENTENCING COMMISSION
1331 PENNSYLVANIA AVENUE, NW
SUITE 1400
WASHINGTON, D.C. 20004
(202) 682-8800

William W. Wilkins, Jr. Chairman
Michael K. Block
Stephen G. Breyer
Helen G. Corrothers
George E. MacKinnon
Ilene H. Nagel
Paul H. Robinson
Benjamin F. Baer (ex officio)
Ronald L. Gainer (ex officio)



November 30, 1988

MEMORANDUM:

TO: Commissioners
Staff Director
Legal, Research, Hotline & Drafting Staffs

FROM: Paul K. Martin *PK*

SUBJECT: Testimony & Written Submission

Appended for your review is written testimony from Professor Chris Stone, one of the witnesses scheduled for Friday's public hearing. Also attached are comments from Robert Monks of the Institutional Shareholder Services, Inc., regarding the issue of corporate governance. Additional comment and testimony will be circulated upon receipt.

Attachments

Testimony: Christopher Stone

Submission: Robert Monks

UNITED STATES SENTENCING COMMISSION

1331 PENNSYLVANIA AVENUE, NW

SUITE 1400

WASHINGTON, D.C. 20004

(202) 662-8800

William W. Wilkins, Jr. Chairman
Michael K. Block
Stephen G. Breyer
Helen G. Corrothers
George E. MacKinnon
Ilene H. Nagel
Benjamin F. Baer (ex officio)
Ronald L. Gainer (ex officio)



November 28, 1988

MEMORANDUM:

TO: Commissioners
Staff Director
Legal, Drafting, Hotline, Research Staffs

FROM: Paul K. Martin *PK*

SUBJECT: Testimony for Pasadena Hearing

Appended for your review are the first four submissions from witnesses scheduled to testify at the Pasadena public hearing on December 2. Additional testimony will be circulated upon receipt.

Attachments

Testimony: Richard Gruner
Maygene Giari
Arthur Levine
Jerome Wilkenfeld

UNITED STATES SENTENCING COMMISSION

Los Angeles, Calif. Hearings December 2, 1988

Statement of

Christopher D. Stone

Law School, University of Southern California

My name is Christopher D. Stone. I am Roy P. Crocker Professor of Law at the University of Southern California. I did my undergraduate work in philosophy at Harvard and took my law degree at Yale as an antitrust major. After a year as Fellow in Law and Economics at the University of Chicago I practiced in New York with Cravath, Swaine and Moore before joining the U.S.C. faculty. I have served on or consulted various government agencies and commissions in several areas.

Over the years one of my principal interests has been the development of strategies for the control of corporate misconduct. My writings on the subject include my book, Where The Law Ends, as well as articles in journals including the Harvard Business Review, the Iowa, Pennsylvania, Wisconsin and Yale Law Journals, Business and Society Review, The Public Interest, Working Papers, and NOMOS (American Society of Political and Legal Philosophy).

The Staff's Contributions

I should begin by saying how impressed I am by the work of the Commission staff. As one who regards organizational misconduct as a significant social problem, I especially appreciate the Commission's taking this occasion to ventilate some very fundamental issues. The details of the specific proposals represent a lot of hard, concerted thinking. I say this even though I find some of the details, such as the recommended multiples, mysterious. Jeffrey Parker's background paper is a welcome and punchy contribution to the literature. In the last analysis I think it over-emphasizes one foundational basis for law-making at the cost of slighting attention to some of the competing, more conventional viewpoints. (I say this even as one who has literally been a part of, and continues to admire, the Chicago School). But even where we differ, I have no doubt Mr. Parker has done all of us working in the field a service. For just one example, the relationship between criminal fines and other monetized responses to the same delict raises complex issues that have been flagged from time to time by commentators, but always allowed somehow to slip from view without any satisfying rejoinder, much less resolution. The Commission does

Christopher D. Stone
Page 2

well to resurface the discussion.

Moreover, everyone working in the field will value the work Messrs. Cohen, Ho, Jones and Schliech have done gathering a data base on present corporate sentencing practices in the federal courts. We have been too long reliant on "smoothing out" the gaps in the heretofore available fragmentary and impressionistic data with hunch and anecdote. I hope that the Commission will continue to underwrite further data-gathering along the lines of that Preliminary Draft.

Not incidentally (on the subject of hunches) the data they have produced suggests that the courts, in administering the criminal side of the process, has visited sanctions even more lenient, on average, than many of us skeptics had supposed. The Cohen, et al. Table 8 (p. 20) shows (for their sampling) an average fine for the four year period of just over \$48,000 and an average total monetary sanction of about \$141,000. I am not quite certain how the associated "losses" were calculated (Tables 10 and 11) but my own reaction was to be struck by the lowness of the inferred multiple. In some areas, the fines, even the total monetary sanctions, averaged less than the estimated social loss. I like to think that whatever difference of opinion there may be, we are all agreed that this is a situation that requires some remedying.

The Discussion Draft's Position on Traditional Sanctions

I am assuming that the principal reason for my appearing here today is to say a few words about, and respond to your questions concerning, the probation proposal that Jack Coffee, Richard Gruner and I have submitted for your consideration. I would like to spend most of my time addressing that proposal.

On the other hand, much of the support for that proposal you already have in writing. Moreover, the argument in favor of probation, and the rest of the alternative sentences, advances in proportion to perceived weaknesses in the traditionally predominant -- we could call it the "nonalternative" -- strategy, that of threatening the corporation with a monetary loss if it runs afoul of the law. So, let me talk about the traditional strategies first.

On this score, my own view and that embodied in the Discussion Draft (DD) are not "worlds [perhaps only continents] apart." We have the same starting point: by-and-large, if private gain exceeds external cost, an activity should be allowed to continue. Further, that as a presumptive strategy, the society, when it wants to restrict various forms of undesirable conduct, ought to do so by tempering the private cost the actor faces

through manipulation of expected sanction levels. Further, that (again as a general rule) once we have communicated to the managers that monetized message of the outside world's concerns, we do best to let the corporate managers adjust to the threat as they see fit, by, for example, changing, at their discretion, methods of production, patterns of monitoring agents, and so on.

My position has always been that any deviations from this strategy, including the judicial imposition of bureaucracy-affecting probation orders, ought to be the exception, held in reserve for special circumstances. Here my only difference with the DD goes, as we shall see, to how restrictively "special circumstances" is to be construed.

Where, then, do I have reservations about the basic (nonprobationary) portions of the Discussion Draft?

I

THE NONPROBATIONARY PROVISIONS

The Definition of "Offense Loss" and its Role

Essentially, I have strong reservations with the definition of "offense loss" and the role that it has been assigned. In constructing the base for the penalty level, the DD places exclusive emphasis on the social loss caused by the offense, and rejects any regard for (a) the wrongdoer's gain or (b) the wealth or other index of how painful a given level of penalty will be for any particular defendant.¹

To begin with, there are many crimes where the legislature

¹In taking this stance, the DD appears to disregard a good deal of traditional horse-sense about sentencing corporations, as well as a certain amount of Congressional sentiment. "Fines equal in amount do not necessarily impose equal punishment. A \$5000 fine for a millionaire is less severe than a \$5000 fine for a person whose annual income is \$15,000." House Comm. on the Judiciary on Criminal Fine Enforcement Act of 1984, H.R. 98-906, 98th Cong., 2d Sess. 3, reprinted in 1984 U.S. Code Cong. & Admn. News, 5433, 5435. Obviously, if, as the drafters of the DD feel, the role of the law is not so much to mete out punishment as to establish the tariff for wrongfully-caused harm, the inequality of punishment, as such, is not an objection. Yet, even if we put punishment aside, and worry, as the DD does, about deterrence, if (as one imagines) the deterrent threat of a penalty is a function of the actor's wealth, then need differences in wealth not be accounted for on that score?

Social Loss vs. Gain to Δ
2. "painfulness" of fine

rightly expects the judiciary to exact a sanction that anchors neither in harm nor in gain, but rather in some societal notion of just punishment, e.g., murder and rape. It is true that many of the crimes corporations get entangled in, such as so-called "regulatory offenses," are less freighted with moral opprobrium. But just punishment cannot be dismissed as categorically inapplicable to each and every corporate crime. Corporations have been indicted for murder, too. And one can imagine a defense contractor's violation of trust, or its mercenary compromise of national security, for which calculations of gain and loss appear inappropriate as exclusive determinant of the penalty level.

I grant that in many (perhaps most) areas of corporate sentencing, economic considerations are significant, even dominating. But in this subset of cases where social costs and benefits is the dominant factor, I lament the single-minded emphasis of the DD of gain over loss. Partly, gain is rejected on the assumption that it is the avoidance of loss that motivates society to criminalize conduct. I don't think that assumption is true categorically. Surely the specter of gain wrongfully acquired is as capable as wrongful harm of arousing the feelings that forge the criminal law. One infers that there is another reason to disregard gain: that if the law focuses on losses, presenting the actor with the "tariff" for law-violation, then a loss-based rule will not dissuade the actor from what my contracts-teaching colleagues might characterize (if this were contracts!) as efficient breach of their social compact.

Most of us feel that there is some range of regulatory crimes (whether they be denominated "violations" or "infractions" or whatever) for which the criminal sanction might be regarded for various purposes as a sort of tariff. Overloading trucks has been so regarded from time to time. But it is a mistake to generalize from the overloaded truck to the entire range of crimes in which a corporation can engage. Does anyone want a corporation to wilfully violate trading with the enemy acts, if its gain exceeds the cognizable losses the courts are likely to confront it with?

In those regions of conduct in which some economic accounting is appropriate at the sentencing stage, I favor as a base the higher of gain or loss; even then, I would select the higher of expected or actual gain or loss. To illustrate, if X Corp. wilfully violated a criminal statute, resulting in \$1 million in environmental damage, I would not wish to see the fine reduced on the plea that the expected damages (for the conduct in question? the class of conduct?) was only \$100,000. On the other hand, a violator whose misconduct released a life-endangering toxic cloud, which was, however, fortuitously dissipated by a sudden windstorm, ought not to have its penalty lowered because

*loss based
fines will
lead to
"efficient
crime"*

Nature bestowed on it a bit of "moral luck."²

I am not disregarding of the general validity of the argument that if a fundamentally productive activity results in an excess of (private) gain over (external) loss, presumptively the activity ought not to be suppressed. Indeed, that is one of several reasons why crimes ancillary to most economic activities are subject to the loss-anchored "penalties" of the laws of torts. What, however, is the person charged with sentencing to make of the fact that criminalization represents a deliberate legislative decision to remove selected areas of conduct from torts (exclusively)? One thing we may understand Congress to be saying by criminalization is that wrongdoer's gain, as well as victim's loss, may be considered at the sentencing stage. Indeed, Congress has provided as much in sec. 3623.

Consider the Y Corp., whose fraudulent claims on behalf of a fairly decent product net it \$1,000,000; the losses of the defrauded buyers, measured by the difference between value surrendered and value received, is \$200,000. Competitors' losses were another \$200,000. Assume the injury to the market through lost confidence, etc. (can such a thing really be measured?) is \$100,000. I find it hard to believe that the law should effectively condone this conduct upon the testimony of the market, that the wrongdoer's gains exceed the offense loss. Surely the gain (subject to some multiple) should be disregarded.

The Discussion Draft's apparent reluctance to endorse 3623's posture stems from a deep-seated anxiety (of phobic proportions, I sometimes thought) of "overdeterrence." Indeed, no one doubts that the law should be cautious not to overdeter socially beneficial behavior. Overdeterrence is a problem that merits addressing on several fronts, for example, by clarifying, where appropriate, the boundaries between legal and prohibited conduct. But, first, to judge from the Commission's own findings of current levels of corporate sanctions --- a \$48,000 average fine --- overdeterrence would hardly appear to constitute a clear and present danger to the social system.

²I am not certain how wide is the variance between my own views and those of the Discussion Materials. Obviously I am taking exception to the rejection of gain. As for the treatment of loss, see the discussion of 8.2, where, in the course of explaining "offense loss", it is explained that "Losses that actually occurred, were intended and reasonably probable, or were imminently threatened by inchoate offenses, are all included in the loss determination." Certainly they are not all cumulated; if the highest of the set is intended, perhaps that ought to be stated clearly.

Second, the notion of overdetering "beneficial activity" is more complicated than one might suppose. One is tempted to draw an easy line between crimes ancillary to legitimate economic activity and common law crimes. That is, one notes that there is no way we could overdeter rapists and murderers; but it is another matter when we threaten our steel companies with fines: we risk over-restricting the production of steel. The difficulties with this analysis consists in the clumping of activities, of how closely the permissible activity comes to the "borderline of impermissible conduct."³ Consider making steel, for example, and fixing the price of steel in clandestine meetings. Are they one beneficial activity, or two activities, the one, beneficial, the other, without any redeeming social value? If --as I would argue-- two, then it exemplifies a situation in which fear of overdeterrence seems no more valid a problem than the fear of overdetering rape.

I do not mean by any of this to disparage efforts at law-reform. It is simply to note that in this (and several other respects)⁴ the proposals, regarded operationally, are, almost as much as proposals for reform of sentencing standards, proposals to partially decriminalize a great and ill-defined deal of conduct presently considered criminal. I say partially decriminalize, because the activities Congress has determined to be "crimes" would continue to be subject to criminal investigative procedures, grand juries, etc.; the application of a multiple (and an assessment of enforcement costs) would raise the ante for many violators, even where the chances of civil recovery were slight. But when one considers the modest level of multiple recommended, the provisions for the diminution of the multiple, and the fact that criminal sanctions would be offset by ancillary civil recoveries, the recommendations appear to approach a civil recovery system with the federal prosecutors playing a lead role: the collectors of first resort.⁵

Civil penalties!!

³See United States v. United States Gypsum Co., 438 U.S. 422, 441 (1978). In that case the Court rejected a strict liability standard for a violation of the antitrust laws.

⁴including the merger of the criminally-imposed with civilly imposed sanctions, and the reallocation of individual and corporate penalties.

⁵It is interesting to consider the effect of the proposals on civil negotiations: if the government has already levied a fine of \$1 million, the defendant in subsequent civil suits has the incentive to settle for \$1 million. To do so is not only, as it first appears, costless; considering the tax treatments of

The Discussion Material certainly suggest the possibility that there exist areas of economic conduct presently criminal that would be better entrusted to tort law exclusively. But such a quasi-decriminalization as is outlined here should be undertaken as such, assessed on a selective, violation-by-violation basis --and addressed to Congress or a special commission assembled for that purpose.

The Multiples

How the multiples were arrived at is, as I have said, a mystery to me. The Staff Working Paper acknowledges that we do not have the data, the denominator, as it were, of various species of corporate crime. In murder cases we have (as a good basis for denominator) most of the bodies. It simply is not so with government contract frauds, laundering of money, price-fixing, etc. How does one begin to calculate the total number of violations? And should our interest be on antitrust violations as a whole, or on subclasses: price-fixing schemes that yielded \$10 million gain as a class, and small-scale \$100,000 conspiracies as another. Could they really be expected to have identical probabilities of detection over the same time span?

And then, to come up with a reducible multiple on the scale of 2.5 (!!) suggests that roughly 1/2 of the relevant crimes are detected and brought to successful prosecution and conviction. Will any prosecutorial agency in the country claim such a success rate?

Of course, if we assume the validity of the Staff empirical data, the proposed multiples, if consistently invoked, would apparently raise the average sanctions from their current appallingly low levels. Thus, those who favor a higher level of deterrence might think they had a reason to favor the proposals as a move in the right direction. But when one accounts for the proposed offset of the criminal sanctions by the civil, it is patent that the net shift would be towards a lower level of deterrence overall.

II

THE PROBATIONARY PROVISIONS

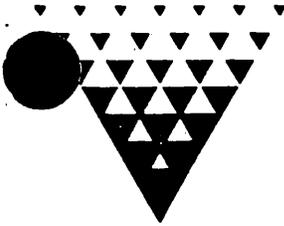
criminal fines and of civil damages, the defendant would have an incentive to shift payment to the civil plaintiffs.

The Commission does not face the question whether probation is a legitimate device in the control of corporate wrongdoing. Congress has expressly provided for it. The approach of the Discussion Materials is, however, to restrict compliance oriented probation (Sec. 8D2.2(c)) to an extremely narrowly defined set of circumstances set forth in Sec. 8D2.1(c). For a compliance-plan triggering order to apply, the case before the court would have to be (1) a felony (2) which senior management either participated in or encouraged; moreover (3) the same company would have to have committed a felony of the same type (over some unspecified interlude) and even then (4) the court would have to determine that (i) a fine alone would be "unlikely to avoid a recurrence while (ii) probation would be likely to avoid deterrence in a cost-justified manner.

Probation is too restrictive

I believe that these conditions as a body over-restrict courts unacceptably. As to the felony limitations in (1) and (4), there are not many felony violations applicable to organizations, but there are certainly many serious patterns of non-felony crimes that might warrant probation in the circumstances. Consider, for example, a defense contractor or nuclear licensee that consistently misreports data or ignores safety requirements.⁶ In both cases, it appears to be particularly unrealistic to suppose we can carry through on fines of a magnitude that would drive the firm out of business: imagine the contractor to be the sole source supplier of a major weapons system, and the licensee to be a utility. A court order-compliance plan would appear to be exactly in order. And that seems to be true quite irrespective of condition (2), that senior management be involved. Indeed, I would argue that the compliance plan is all the more needed where senior management were not involved. First, in cases where senior management were involved, it is all the more likely that individual sanctions against them will be effective strategies. Cases against the organization are all the more warranted, in my view, where it is difficult to pin down individual liability. Moreover, it is precisely in those cases that a compliance plan is warranted as a means to assure that the firm's bureaucratic structure include elements that ensure the effectiveness of management review of the problem area -- and unambiguously locate responsibility if something were to go wrong again.

⁶Violations of nuclear safety regulations by a licensee would in the first instance be under the purview of the NRC, which has the power in some circumstances to deprive a licensee of its license; on the other hand the federal courts might be called upon to enforce criminal sanctions, and, indeed, a court might feel that the NRC was not doing an adequate job protecting the public interest.



INSTITUTIONAL
SHAREHOLDER
SERVICES, INC.

November 23, 1988

Honorable William Wilkins, Jr.
Chairman
The United States Sentencing Commission
1331 Pennsylvania Avenue, N.W., Suite 1400
Washington, DC 20004

Dear Chairman Wilkins:

We have been working for some time in the area of corporate governance. In connection therewith we have been very much concerned with the question of corporate crime. Simply stated, our clients, who are the largest institutional shareholders (pension funds, foundations, universities and the like), do not want their companies to violate law; they do not want their managers to consider the matter of compliance with the law as essentially one of cost benefit analysis. We have, therefore, begun the process of mobilizing ownership interests and, in connection therewith, have sent out the enclosed material to a variety of leading American companies.

I hope that this information is helpful to you in your work. Please let us know if there is anything further that we might provide.

Sincerely,

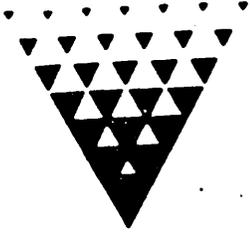
Robert A. G. Monks

Enc.

3050 K ST. N.W. SUITE 300

WASHINGTON, DC 20007

PHONE 202/944 4800



INSTITUTIONAL
SHAREHOLDER
SERVICES, INC.

October 26, 1988

Mr. Warren H. Phillips
Chairman of the Board
Dow Jones & Company, Inc.
200 Liberty Street
New York, NY 10281

Dear Mr. Phillips:

Institutional Shareholder Services, Inc. is a consulting firm that advises large institutional shareholders on corporate governance issues. Our clients are long-term investors with a substantial equity position in your company. They believe that exercise of the rights of ownership can protect and enhance the value of their investments, and that as fiduciaries for the beneficial owners of the stock, they must do so when it is economically justified.

3050 K ST. N.W. SUITE 300

WASHINGTON, DC 20007

PHONE 202 944 4800

Our clients are increasingly concerned about corporate crime, not just as a matter of public policy, but as a matter of investment policy. Companies that break the law incur huge legal fees and fines. They must devote enormous resources to preparing their defense. They lose goodwill in the community, and they lose business.

We have been impressed with your company's exemplary record, both in corporate governance and in making a commitment to the highest standards of ethical behavior. Our clients have demonstrated their support by buying and holding your stock. The latest figures we have show that institutions hold more than 30% of your shares. We would like you to go one step further in establishing your commitment to shareholder concerns and compliance with the laws by proposing the adoption of a by-law along the lines of the enclosed.

October 26, 1988

Page 2

The by-law provides that any director who is convicted of a felony in connection with his or her service as a director will become ineligible for service on the Board. Similarly, any director serving at a time when the corporation is criminally convicted will also become ineligible for continued service (unless he or she voted against the conduct leading to the criminal conviction).

This by-law is intended to reach only the most extraordinary violations. It would not be triggered by criminal charges against corporate officers or employees (unless they also serve as directors). Some infractions are inevitable. Laws and regulations are complex, and their interpretation and enforcement vary enormously from one administration to another. Shareholders do not want companies to be so risk-averse that they always adopt the most conservative interpretation possible; sometimes it is worthwhile to challenge the law. And Congress has a tendency to react to a problem by making it criminal; Congress tries to appear to be cracking down on defense contractors and polluters, and does so by characterizing relatively minor violations as criminal. But directors must take the responsibility for setting some standards for the company.

The most important right granted to shareholders in exchange for their funds is the right to elect directors. That right carries with it the right to establish criteria for eligibility. The shareholders we work with would like to see you initiate action to adopt a by-law along the lines of the enclosed draft to make it clear that you have a strong commitment to complying with the law, and a commitment to being responsive to shareholder concerns. We believe it would enhance your standing in the community and the value of their investment. We cannot see any possible case in which your company would want to retain a director covered by this by-law; adoption would simply make the removal automatic.

October 26, 1988

Page 3

We would appreciate the opportunity to discuss this proposal with you. We are interested in your reaction, and we look forward to hearing from you.

Sincerely,



Robert A. G. Monks
President

Enclosure

**LIST OF ADDRESSEES FOR "LETTER A" CONCERNING PROPOSED CORPORATE
CRIMINAL ACTIVITY BY-LAW**

Mr. Warren H. Phillips
Chairman of the Board
Dow Jones & Company, Inc.
200 Liberty Street
New York, NY 10281

Mr. Colby H. Chandler
Chief Executive Officer
Eastman Kodak Company
343 State Street
Rochester, NY 14650

Mr. James R. Stover
President and Chief Executive Officer
Eaton Corporation
1111 Superior Avenue
Cleveland, OH 44114

Mr. John F. Welch, Jr.
Chairman of the Board
General Electric Company
3135 Easton Turnpike
Fairfield, CT 06413

Mr. Bernard Schwartz
Chairman and Chief Executive Officer
Loral Corporation
600 Third Avenue
New York, NY 10016

Mr. Norman R. Augustine
Chairman and Chief Executive Officer
Martin Marietta Corporation
6801 Rockledge Drive
Bethesda, MD 20817

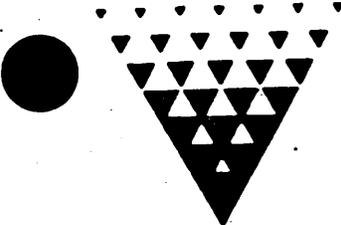
Mr. George M.C. Fisher
President and Chief Executive Officer
Motorola, Inc.
1303 East Algonquin Road
Schaumburg, IL 60196

Mr. Frank A. Shrontz
Chairman and Chief Executive Officer
The Boeing Company
P.O. Box 3707
Seattle, WA 98124

**LIST OF ADDRESSEES FOR "LETTER A" CONCERNING PROPOSED CORPORATE
CRIMINAL ACTIVITY BY-LAW**

**Mr. Frank P. Popoff
President and Chief Executive Officer
The Dow Chemical Company
2030 Willard H. Dow Center
Midland, MI 48674**

**Dr. Ruben F. Mettler
Chief Executive Officer
TRW Inc.
1900 Richmond Road
Cleveland, OH 44124**



INSTITUTIONAL
SHAREHOLDER
SERVICES, INC.

October 26, 1988

Mr. Lawrence G. Rawl
Chairman and Chief Executive Officer
Exxon Corporation
1251 Avenue of the Americas
New York, NY 10020-1198

Dear Mr. Rawl:

Institutional Shareholder Services, Inc. is a consulting firm that advises large institutional shareholders on corporate governance issues. Our clients are long-term investors. They believe that exercise of the rights of ownership can protect and enhance the value of their investments, and that as fiduciaries for the beneficial owners of the stock, they must do so when it is economically justified.

Our clients are increasingly concerned about corporate crime, not just as a matter of public policy, but as a matter of investment policy. Companies that break the law incur huge legal fees and fines. They must devote enormous resources to preparing their defense. They lose goodwill in the community, and they lose business.

Our clients have expressed serious concerns about your commitment to compliance with the law. The latest figures we have show that institutions hold more than 33% of your shares. They are long-term investors; they would prefer not to sell out because of their concerns, especially since they believe that your poor record has depressed the stock. Their alternative, then, is to work with you to improve value. We would like you to establish your commitment to shareholder concerns and compliance with the laws by proposing the adoption of a by-law along the lines of the enclosed.

3050 K ST. N.W. SUITE 300

WASHINGTON, DC 20007

PHONE 202/944 4800

October 26, 1988

Page 2

The by-law provides that any director who is convicted of a felony in connection with his or her service as a director will become ineligible for service on the Board. Similarly, any director serving at a time when the corporation is criminally convicted will also become ineligible for continued service (unless he or she voted against the conduct leading to the criminal conviction).

This by-law is intended to reach only the most extraordinary violations. It would not be triggered by criminal charges against corporate officers or employees (unless they also serve as directors). Some infractions are inevitable. Laws and regulations are complex, and their interpretation and enforcement vary enormously from one administration to another. Shareholders do not want companies to be so risk-averse that they always adopt the most conservative interpretation possible; sometimes it is worthwhile to challenge the law. And Congress has a tendency to react to a problem by making it criminal; Congress tries to appear to be cracking down on defense contractors and polluters, and does so by characterizing relatively minor violations as criminal. But directors must take the responsibility for setting some standards for the company.

The most important right granted to shareholders in exchange for their funds is the right to elect directors. That right carries with it the right to establish criteria for eligibility. The shareholders we work with would like to see you initiate action to adopt a by-law along the lines of the enclosed draft, to make it clear that you have a strong commitment to complying with the law, and a commitment to being responsive to shareholder concerns. We believe it would enhance your standing in the community and the value of their investment. We cannot see any possible case in which your company would want to retain a director covered by this by-law; adoption would simply make the removal automatic.

October 26, 1988

Page 3

We would very much appreciate the opportunity to discuss this proposal with you. We are most interested in your reaction, and we look forward to hearing from you.

Sincerely,

Robert A. G. Monks
President

Enclosure

**LIST OF ADDRESSEES FOR "LETTER B" CONCERNING PROPOSED CORPORATE
CRIMINAL ACTIVITY BY-LAW**

Mr. E. Claiborne Robins, Jr.
President and Chief Executive Officer
A.H. Robins Company, Inc.
1407 Cummings Drive
P.O. Box 26609
Richmond, VA 23261-6609

Dr. Leon Riebman
Chairman and Chief Executive Officer
AEL Industries
305 Richardson Rd.
Lansdale, PA 19446

Mr. John R. Hall
Chairman and Chief Executive Officer
Ashland Oil, Inc.
1000 Ashland Drive
Russell, KY 41169

Dr. Richard Theuer
President
Beech-Nut Nutrition Corporation
P.O. Box 127
Ft. Washington, PA 19034

Mr. Harry J. Phillips, Sr.
Chairman and Chief Executive Officer
Browning-Ferris Industries, Inc.
P.O. Box 3151
Houston, TX 77253

Mr. Richard E. Heckert
Chairman and Chief Executive Officer
E. I. DuPont de Nemours and Company
D 9000
1007 Market Street
Wilmington, DE 19898

Mr. Richard D. Wood
President, Chairman and Chief Executive Officer
Eli Lilly and Company
Corporate Center
Indianapolis, IN 46285

Mr. Lawrence G. Rawl
Chairman and Chief Executive Officer
Exxon Corporation
1251 Avenue of the Americas
New York, NY 10020-1198

**LIST OF ADDRESSEES FOR "LETTER B" CONCERNING PROPOSED CORPORATE
CRIMINAL ACTIVITY BY-LAW**

**Mr. Alfred Manville
President and Chief Executive Officer
Fischbach Corporation
485 Lexington Avenue
New York, NY 10017**

**Mr. Stanley C. Pace
Chairman and Chief Executive Officer
General Dynamics Corporation
Pierre Laclède Center
St. Louis, MO 63105**

**Mr. C. David Ferguson
Chairman and Chief Executive Officer
Gould Inc.
35129 Curtis Blvd.
Eastlake, OH 44094**

**Mr. James L. Johnson
Chairman and Chief Executive Officer
GTE Corp.
One Stamford Forum
Stamford, CT 06904**

**Mr. John T. Hartley
Chief Executive Officer
Harris Corporation
1025 W. NASA Boulevard
Melbourne, FL 32919**

**Mr. Rod F. Danneyer
President and Chief Executive Officer
IteI Corp.
2 N. Riverside Plaza
Chicago, IL 60606**

**Mr. Orion L. Hoch
Chairman and Chief Executive Officer
Litton Industries, Inc.
360 North Crescent Drive
Beverly Hills, CA 90210**

**Mr. Larry O. Kitchen
Chairman and Chief Executive Officer
Lockheed Corporation
4500 Park Granada Boulevard
Calabasas, CA 91399**

**LIST OF ADDRESSEES FOR "LETTER B" CONCERNING PROPOSED CORPORATE
CRIMINAL ACTIVITY BY-LAW**

Mr. John F. McDonnell
Chairman and Chief Executive Officer
McDonnell Douglas Corp.
P.O. Box 516
St. Louis, MO 63166

Mr. Richard J. Mahoney
Chairman and Chief Executive Officer
Monsanto Company
800 N. Lindbergh Boulevard
St. Louis, MO 63167

Mr. Charles S. Locke
Chairman of the Board
Morton Thiokol, Inc.
110 North Wacker Drive
Chicago, IL 60606-1560

Mr. Helmut Maucher
Managing Director
Nestle S.A.
Case Postale 353
1800 Vevey
Switzerland

Mr. Thomas V. Jones
Chairman and Chief Executive Officer
Northrop Corporation
1840 Century Park East
Los Angeles, CA 90067

Mr. Armand Hammer
Chairman and Chief Executive Officer
Occidental Petroleum Corp.
10889 Wilshire Blvd.
Los Angeles, CA 90024

Mr. Charles D. Strang
Chairman and Chief Executive Officer
Outboard Marine Corp.
100 Sea-Horse Drive
Waukegan, IL 60085

Mr. John J. Mitcham
President and Chief Executive Officer
Paradyne Corp.
8550 Ulmerton Road
Largo, FL 34649-2826

**LIST OF ADDRESSEES FOR "LETTER B" CONCERNING PROPOSED CORPORATE
CRIMINAL ACTIVITY BY-LAW**

**Mr. Paul G. Schloemer
President and Chief Executive Officer
Parker-Hannifin Corporation
17235 Euclid Avenue
Cleveland, OH 44112**

**Mr. Edwin E. Tuttle
Chairman and Chief Executive Officer
Pennwalt Corp.
Three Parkway
Philadelphia, PA 19102**

**Mr. D. Wayne Calloway
Chairman and Chief Executive Officer
PepsiCo Inc.
Anderson Hill Road
Purchase, NY 10577**

**Mr. Peter R. Fink
President and Chief Executive Officer
R.P. Scherer Corp
2075 West Big Beaver Rd.
Suite 700
Troy, MI 48084**

**Mr. Donald R. Beall
Chairman and Chief Executive Officer
Rockwell International Corporation
2230 East Emperial Highway
El Segundo, CA 90245**

**Mr. Henry Wendt
Chairman of the Board
SmithKline Bechman Corporation
One Franklin Plaza
P.O. Box 7929
Philadelphia, PA 19101**

**Mr. Evans W. Erikson
Chairman and Chief Executive Officer
Sundstrand Corp.
4949 Harrison Ave.
P.O. Box 7003
Rockford, IL 61125-7003**

**LIST OF ADDRESSEES FOR "LETTER B" CONCERNING PROPOSED CORPORATE
CRIMINAL ACTIVITY BY-LAW**

Mr. Dennis R. Hendrix
President and Chief Executive Officer
Texas Eastern Corp.
Box 2521
Houston, TX 77252

Mr. Robert E. Mercer
Chairman of the Board
The Goodyear Tire & Rubber Company
1144 East Market Street
Akron, OH 44316-0001

Mr. Robert D. Kennedy
Chairman of the Board
Union Carbide Corporation
39 Old Ridgebury Road
Danbury, CT 06817-0001

Mr. Richard J. Stegemeier
President and Chief Executive Officer
Unocal Corporation
P.O. Box 7600
Los Angeles, CA 90051

Mr. Thomas D. Sege
Chairman and Chief Executive Officer
Varian Associates, Inc.
611 Hansen Way
Palo Alto, CA 94303

Mr. J. Peter Grace
Chairman, President and
Chief Executive Officer
W. R. Grace & Co.
Grace Plaza
1114 Avenue of the Americas
New York, NY 10036-7794

Mr. John C. Marous
Chairman and Chief Executive Officer
Westinghouse Electric Corporation
Westinghouse Building
Gateway Center
11 Stanwix Street
Pittsburgh, PA 15222

SAMPLE BY-LAW FOR FOOD AND DRUG INDUSTRY VIOLATIONS

RESOLVED, that the by-laws of [] be amended by the adoption of a new Section [], to provide as follows:

"No person ~~who is~~ criminally convicted of a state or federal felony violation for causing death or serious bodily injury to any person by adulterating, misbranding, falsely labeling or falsely advertising a food, drug or device; or who is convicted of a felony violation for obstruction of justice, fraud, corruption of a public official, perjury, or making a false statement in furtherance of or to conceal any such activity; or who is convicted of conspiring to commit or aiding and abetting the commission of any violation described above; whether by trial, guilty plea, or plea of nolo contendere, shall be eligible to serve as a Director or Officer of the corporation for three years from the date of such conviction, unless and until such conviction is overturned or vacated by a court of competent jurisdiction.

Why only 3 years?

If the corporation is criminally convicted of a state or federal felony violation for causing death or serious bodily injury to any person by adulterating, misbranding, falsely labeling or falsely advertising a food, drug or device; or is convicted of obstruction of justice, fraud, corruption of a public official, perjury, or making a false statement in furtherance of or to conceal any such activity; or is convicted of conspiring to commit or aiding and abetting the commission of any violation described above; whether by trial, guilty plea, or plea of nolo contendere, no person who, at the time of the conduct giving rise to the conviction was a Director of the corporation or was the President, Chairman, Chief Executive Officer, or Chief Operating Officer, or was a Vice President, Treasurer or Assistant Treasurer having responsibility for the area of corporate activity where such conduct occurred, and who had held that office for at least one year immediately prior thereto, shall be eligible to serve as a Director or Officer of the corporation for three years from the date of such conviction, unless and until such conviction is overturned or vacated by a court of competent jurisdiction. Provided, that if the corporate conduct giving rise to the conviction was the subject of a vote of the Board of Directors, then this provision shall not apply to any Director who cast his or her vote against such conduct.

Any disqualification effected by this by-law may be removed by a vote of the holders in beneficial interest of 75% or more of the corporation's shares then outstanding."

SUPPORTING STATEMENT

The purpose of this resolution is to ensure that Directors and Officers are held accountable to shareholders for engaging in or allowing the corporation to engage in criminal conduct that goes to the heart of the corporation's activities. Criminal conduct of this nature, which threatens public health and safety, exposes the corporation to massive criminal fines and civil damage awards, and destroys corporate good will, is never in the best interest of the shareholders or the corporation, and should not be countenanced.

SAMPLE BY-LAW FOR ANTITRUST LAW VIOLATIONS

RESOLVED, that the by-laws of [] be amended by the adoption of a new Section [], to provide as follows:

"No person who is criminally convicted of a state or federal felony violation for price-fixing or other violation of the antitrust laws, or who is convicted of a felony violation for obstruction of justice, fraud, corruption of a public official, perjury, or making a false statement in furtherance of or to conceal any such activity; or who is convicted of conspiring to commit or aiding and abetting the commission of any violation described above; whether by trial, guilty plea, or plea of nolo contendere, shall be eligible to serve as a Director or Officer of the corporation for three years from the date of such conviction, unless and until such conviction is overturned or vacated by a court of competent jurisdiction.

If the corporation is criminally convicted of a state or federal felony violation for price-fixing or other antitrust violation, or is convicted of obstruction of justice, fraud, corruption of a public official, perjury, or making a false statement in furtherance of or to conceal any such activity; or is convicted of conspiring to commit or aiding and abetting the commission of any violation described above; whether by trial, guilty plea, or plea of nolo contendere, no person who, at the time of the conduct giving rise to the conviction was a Director of the corporation or was the President, Chairman, Chief Executive Officer, or Chief Operating Officer, or was a Vice President, Treasurer or Assistant Treasurer having responsibility for the area of corporate activity where such conduct occurred, and who had held that office for at least one year immediately prior thereto, shall be eligible to serve as a Director or Officer of the corporation for three years from the date of such conviction, unless and until such conviction is overturned or vacated by a court of competent jurisdiction. Provided, that if the corporate conduct giving rise to the conviction was the subject of a vote of the Board of Directors, then this provision shall not apply to any Director who cast his or her vote against such conduct.

Any disqualification effected by this by-law may be removed by a vote of the holders in beneficial interest of 75% or more of the corporation's shares then outstanding."

SUPPORTING STATEMENT

The purpose of this resolution is to ensure that Directors and Officers are held accountable to shareholders for engaging in or allowing the corporation to engage in criminal conduct that goes to the heart of the corporation's activities. Criminal conduct of this nature exposes the corporation to massive criminal fines and civil damage awards, and destroys corporate good will, is never in the best interest of the shareholders or the corporation, and should not be countenanced.

SAMPLE BY-LAWS FOR DEFENSE PROCUREMENT VIOLATIONS

2.17 Qualification of Directors and Officers in the Event of Criminal Convictions.

No person who has been criminally convicted of a state or federal felony for

(a) defrauding the United States Government via one or more instances of cost misallocation, product substitution, failure to perform required tests, defective pricing, bid-rigging, or corruption of a public official,

(b) obstruction of justice, perjury or making a false statement in furtherance of or to conceal any activity described in (a) above,

(c) conspiring to commit or aiding or abetting the commission of any violation described in (a) or (b) above, or

(d) racketeering activity in which any of the violations described in (a), (b), or (c) above or state law bribery is an element,

whether by trial, guilty plea, or plea of nolo contendere, shall be eligible to be elected or to serve as an Officer or Director of the corporation for a period of three years from the date of such conviction, unless and until such conviction is overturned or vacated by a court of competent jurisdiction.

If the corporation is at any time criminally convicted of a state or federal felony violation for

(a) defrauding the United States Government via one or more instances of cost misallocation, product substitution, failure to perform required tests, defective pricing, bid-rigging, or corruption of a public official,

(b) obstruction of justice, perjury or making a false statement in furtherance of or to conceal any activity described in (a) above,

(c) conspiring to commit or aiding or abetting the commission of any violation described in (a) or (b) above, or

(d) racketeering activity in which any of the violations described in (a), (b), or (c) above is an element,

whether by trial, guilty plea, or plea of nolo contendere, no person who, at the time of the conduct giving rise to the conviction, was a Director of the corporation or was the President, Chairman, Chief Executive Officer, or Chief Operating Officer of the corporation, or who was a Vice-President, Treasurer, or Assistant Treasurer having responsibility for the area of corporate activity where such conduct occurred, and who had held such office for at least one year immediately prior thereto, shall be eligible to be elected or to serve as an Officer or Director of the corporation for a period of three years from the date of such conviction, unless and until such conviction is overturned or vacated by a court of competent jurisdiction. Provided, however, that if the corporate conduct giving rise to the conviction was the subject of a vote of the Board of Directors of the corporation, then this provision shall not apply to any Director who cast his or her vote against such conduct.

The felony offenses referred to in this by-law include, without limitation of any kind whatsoever upon the generality of the foregoing, violations of Title 18, United States Code, Section 201 (bribery), Sections 286 and 287 (fraudulent claims), Section 1001 (false statements), Section 1341 (mail fraud), Section 1343 (wire fraud), Section 1503, 1510, 1512 and 1513 (obstruction of justice), Section 1621 (perjury), Section 1952 (travel in aid of racketeering); Section 1962 (R.I.C.O.), Section 371 (conspiracy to defraud the United States), and Section 2 (aiding and abetting), and state law felony offenses involving the same or similar conduct.

A person affected by the operation of this by-law may be rendered eligible to be elected and to serve as a Director or Officer of the corporation prior to the expiration of the three year post-conviction period upon a vote in favor of such eligibility by the holders in beneficial interest of 75% or more of the corporation's shares then outstanding.

SUPPORTING STATEMENT

The purpose of this resolution is to ensure that Directors and Officers are held accountable to shareholders for engaging in or allowing the corporation to engage in criminal conduct that goes to the heart of the corporation's activities. Criminal conduct of this nature exposes the corporation to massive criminal fines and civil damage awards, and destroys corporate good will, is never in the best interest of the shareholders or the corporation, and should not be countenanced.

SAMPLE BY-LAW FOR ENVIRONMENTAL LAW VIOLATIONS

2.17 Qualification of Directors and Officers in the Event of Criminal Convictions.

No person who is criminally convicted of a state or federal felony violation for knowingly ~~or~~ recklessly endangering human health or the environment through the generation, disposal, storage, transportation, treatment or management of a hazardous substance; or who is convicted of a felony violation for obstruction of justice, fraud, corruption of a public official, perjury, or making a false statement in furtherance of or to conceal any such activity; or who is convicted of conspiring to commit or aiding and abetting the commission of any violation described above, whether by trial, guilty plea, or plea of nolo contendere, shall be eligible to be elected or to serve as a Director or Officer of the corporation for a period of three years from the date of such conviction, unless and until such conviction is overturned or vacated by a court of competent jurisdiction.

If the corporation is at any time criminally convicted of a state or federal felony violation for knowingly or recklessly endangering human health or the environment through the generation, disposal, storage, transportation, treatment or management of a hazardous substance; or is convicted of a felony violation for obstruction of justice, fraud, corruption of a public official, perjury, or making a false statement in furtherance of or to conceal any such activity; or is convicted of conspiring to commit or aiding and abetting the commission of any violation described above, whether by trial, guilty plea, or plea of nolo contendere, no person who, at the time of the corporate conduct giving rise to the conviction, was a Director of the corporation, or was the President, Chairman, Chief Executive Officer, or Chief Operating Officer of the corporation, or was a Vice-President, Treasurer or Assistant Treasurer having responsibility for the area

of corporate activity where such conduct occurred, and who had held such position for at least one year immediately prior thereto, shall be eligible to be elected or to serve as a Director or Officer of the corporation for a period of three years from the date of such conviction, unless and until such conviction is overturned or vacated by a court of competent jurisdiction. Provided, however, that if the corporate conduct giving rise to the conviction was the subject of a vote of the Board of Directors of the corporation, then this provision shall not apply to any Director who cast his or her vote against such conduct.

The felony offenses referred to in this by-law include, without limitation, violations of Title 42, United States Code, Section 6928(d) or (e) (the Solid Waste Disposal Act), Title 49, United States Code, Section 1809(b) (the Hazardous Materials Transportation Act), Title 18, United States Code, Section 201 (bribery), Section 1001 (false statements), Section 1341 (mail fraud), Section 1343 (wire fraud), Sections 1503, 1510, 1512 and 1513 (obstruction of justice), Section 1621 (perjury), Section 371 (conspiracy to defraud the United States), Section 2 (aiding and abetting), and state law felonies involving the same or similar conduct.

A person affected by the operation of this by-law may be rendered eligible to be elected and to serve as a Director or Officer of the corporation prior to the expiration of the three year post-conviction period upon a vote in favor of such eligibility by the holders in beneficial interest of 75% or more of the corporation's shares then outstanding.

SUPPORTING STATEMENT

The purpose of this resolution is to ensure that Directors and Officers are held accountable to shareholders for engaging in or allowing the corporation to engage in criminal conduct that goes to the heart of the corporation's activities. Criminal conduct of this nature exposes the corporation to massive criminal fines and civil damage awards, and destroys corporate good will, is never in the best interest of the shareholders or the corporation, and should not be countenanced.

DEADLINES FOR SHAREHOLDER RESOLUTIONS

Letter A Recipients

Dow Jones & Company, Inc.	November 11, 1988
Eastman Kodak Company	November 23, 1988
Eaton Corporation	November 11, 1988
General Electric Company	November 8, 1988
Loral Corporation	February 24, 1989
Martin Marietta Corporation	November 24, 1988
Motorola, Inc.	November 19, 1988
The Boeing Company	November 23, 1988
The Dow Chemical Company	November 23, 1988
TRW Inc.	November 18, 1988

Letter B Recipients

A.H. Robins Company, Inc.	No meeting scheduled
AEL Industries	January 31, 1989
Ashland Oil, Inc.	August 20, 1988
Beech-Nut Nutrition Corporation	No meeting scheduled
Browning-Ferris Industries, Inc.	September 23, 1988
E. I. DuPont de Nemours and Company	November 18, 1988
Eli Lilly and Company	November 14, 1988
Exxon Corporation	November 28, 1988
Fischbach Corporation	
General Dynamics Corporation	November 28, 1988
Gould Inc.	November 25, 1988
GTE Corp.	November 3, 1988
Harris Corporation	May 17, 1989
Itel Corp.	December 8, 1988

DEADLINES FOR SHAREHOLDER RESOLUTIONS

Litton Industries, Inc.	June 30, 1988
Lockheed Corporation	December 5, 1988
McDonnell Douglas Corp.	November 21, 1988
Monsanto Company	November 11, 1988
Morton Thiokol, Inc.	May 18, 1989
Nestle S.A.	No meeting scheduled
Northrop Corporation	November 30, 1988
Occidental Petroleum Corp.	December 19, 1988
Outboard Marine Corp.	August 5, 1988
Paradyne Corp.	December 5, 1988
Parker-Hannifin Corporation	May 29, 1989
Pennwalt Corp.	November 25, 1988
PepsiCo Inc.	December 1, 1988
R.P. Scherer Corp	March 17, 1989
Rockwell International Corporation	September 7, 1988
SmithKline Bechman Corporation	November 22, 1988
Sundstrand Corp.	November 9, 1988
Texas Eastern Corp.	November 10, 1988
The Goodyear Tire & Rubber Company	October 25, 1988
Union Carbide Corporation	November 17, 1988
Unocal Corporation	November 14, 1988
Varian Associates, Inc.	September 8, 1988
W. R. Grace & Co.	December 1, 1988
Westinghouse Electric Corporation	November 14, 1988

10889 WILSHIRE BOULEVARD
SUITE 400
LOS ANGELES, CALIFORNIA 90024

JEROME WILKENFELD

November 21, 1988

Mr. Paul Martin
U.S. Sentencing Commission
1331 Pennsylvania Avenue NW
Suite 1400
Washington, D.C. 20004

Dear Mr. Martin;

As you requested, enclosed is a copy of the statement I plan
on presenting at the hearing on December 2, 1988 in Pasadena.

I am also enclosing copies of the references which provide
more detail on the type of program which has been so
successful at Occidental Petroleum Corporation.

I look forward to discussing organizational sanctions at the
hearing.

Sincerely,



November 18, 1988

Statement for the U.S. Sentencing Commission

by

Jerome Wilkenfeld

My name is Jerome Wilkenfeld, a consultant to industry in environment, health and safety programs currently working full time for Occidental Petroleum Corporation. Until 1986 I was employed by Occidental as Corporate Director of Health, Environment and Safety. I have over 45 years experience in industrial operations, management and development and implementation of programs for protection of human health and the environment. Additionally I served for 22 years on the New York State Air Pollution Control Board and its successor the Environmental Board. A copy of a brief summary of my experience is attached for your information.

Both Frank Friedman, Occidental's Vice President, Health, Environment and Safety and I have reviewed the Discussion Materials on Organizational Sanctions dated July 1988 and feel that our actual experience in developing and implementing environmental protection oversight and management programs can be of considerable assistance to the Commission in their deliberations in the development of Sentencing Guidelines. Mr. Friedman planned to be here today, but is out of town. He would, however, be happy to meet with you at your convenience when he returns.

Approximately eight years ago Occidental signed a consent decree, without admitting liability, with the Securities and Exchange Commission in settlement of a claim that Occidental had not adequately advised shareholders of the extent of liability on environmental matters among other things. While this settlement did not call for any specific long term actions by Occidental, the company decided to formalize management controls and oversight. This, very successful program, which is discussed in the attached paper¹ and recently published monograph², demonstrate the importance of encouraging organizational change. The importance of such changes is supported by

¹ Frank B. Friedman and Jerome Wilkenfeld, Effective and Turf-free Organization and Management of the Environmental Function Environmental Management Reports No.5, Third Quarter 1987.

² Frank B. Friedman, Practical Guide to Environmental Management Environmental Law Institute 1988.

the paper on organizational probation prepared by Messers Coffee, Gruner and Stone. Such programs of organizational probation are much more meaningful and effective in preventing future non-compliance with laws and regulations than financial penalties described under monetary sanctions in papers prepared for the United States Sentencing Commission.

This is not to imply that it may not be appropriate under certain circumstances to seek recovery of costs, damages and intendant profits when such profits are determinable. Rather that there should be recognition that financial penalties can only have one of two results. Either they are so substantial that they cripple or destroy the company, or they just result in a pass along of the added cost to the shareholders or customers. This recognizes that a company has as its basic function the generation of profit and as such can be simplistically described as no more than a money pass-through vehicle.

On the other hand, ~~if the company being sanctioned is required to institute a strong management system as part of a probation program, the court will assure that it has implemented requirements which will prevent a recurrence of the actions that allowed or caused the violation to occur.~~

The Occidental program which is described briefly here and in more detail in the references cited above, includes four key elements. Please note that while this program is very effective at Occidental, utilization at other companies would have to recognize differences in corporate structure and culture.

The objectives are:

- o regular, timely and uniform reporting from the operating line through senior management to the board of directors,
- o prompt identification and resolution of environmental issues,
- o establishment of preventive programs and procedures and
- o identification of developing issues or trends.

The key elements of the program are:

- o a computerized information and issue management system,
- o a facility assessment program,
- o an internal planning document and timetable,
- o a capital expenditure review system and
- o a legislative and regulatory action program.

Note that each element of the program ties into at least one objective.

This program is very much in keeping with the U.S. Environmental Protection Administration's environmental auditing guidelines and their guidelines for auditing requirements which are included in some consent decrees.

The Occidental program has demonstrated effectiveness as measured by its ability to provide prompt and complete reporting of significant issues to all levels of the corporation and identification and provision of procedures for the taking action on identified issues. Additionally it provides, with minimum staff, a method for the assurance of completeness of reporting, development of indices of performance and documentation of action taken on identified issues. As an example of the efficacy of this program, we have found that there has been orders of magnitude reduction in notices of violation received throughout the corporation during the time this program has been in effect. Additionally, it has been possible to identify developing problems and prevent problems from occurring by review of proposed installations and acquisitions. This demonstrates the effectiveness of strong management controls utilizing a staff of only four professionals for environment and safety at the corporate headquarters of a company doing approximately \$18 billion per year business in over 300 facilities world wide.

We feel this program demonstrates that the best sanctions on industrial organizations is the requirement of strong management oversight rather than financial penalties.

I will be happy to answer any questions.

Environmental Management Report

Number 5

Third Quarter 1987

Effective and Turf-free Organization and
Management of the Environmental Function
Frank B. Friedman and Jerome Wilkenfeld
Occidental Petroleum Corporation

**New Emergency Planning and Community
Right-to-Know Act Requirements**
David J. Hayes
Hogan & Hartson

**EPA's Enforcement and Compliance Program:
Current Priorities**
Thomas L. Adams
U.S. Environmental Protection Agency

**Availability of Environmental Liability
Insurance for Real Estate Transactions**
Carl B. Everett
Liebert, Short, FitzPatrick & Hirshland

**Waste Minimization: The Federal
Perspective**
Kelly L. Allan
U.S. Environmental Protection Agency

**Incineration Strategies in Light of Current
and Future Land Disposal Bans**
Douglas MacMillan
IT Corporation

**Superfund and Federal Regulatory
Controls Governing Used Oil**
Christopher K. Harris
Schmeltzer, Aptaker & Sheppard

**UST Monitoring Perspectives: Practical
Guidance**
Douglas J. Hermann
STS Consultants, Ltd.

**Concerns of Response Action Contractors
and Suggestions on What to Do to Avoid
Problems**
John Ramage
CH2M Hill

**EFFECTIVE AND TURF-FREE ORGANIZATION AND
MANAGEMENT OF THE ENVIRONMENTAL FUNCTION**

Frank B. Friedman
Vice President, Health, Environment & Safety
Occidental Petroleum Corporation
Los Angeles, California
and
Jerome Wilkenfeld
Occidental Petroleum Corporation
Los Angeles, California

About the Authors

Frank B. Friedman, prior to assuming his present position with Occidental Petroleum Corporation in June 1981, held a variety of law and management positions with the Atlantic Richfield Company. Prior to joining Atlantic Richfield, he was an attorney in the Appellate Section, Land & Natural Resources Division, U.S. Department of Justice. He has written and lectured extensively on environmental law and management.

Jerome Wilkenfeld was Corporate Director-Health, Environment and Safety for Occidental Petroleum Corporation until the first of 1986, where he had a major role in the development and implementation of the Occidental Program. He has lectured and published extensively on environmental health and safety matters, and currently is consulting with Occidental Petroleum Corporation.

Presented at the February 1987 course by Government Institutes, "Environmental Management Roundtable."

ENVIRONMENTAL MANAGEMENT REPORT

NEED FOR A DIFFERENT KIND OF ENVIRONMENTAL MANAGEMENT IN THE 1980s

In the 1950s and 1960s, environmental issues were usually not "managed," but rather were left to technicians and not assigned high-level corporate attention or priority.

Then the volume of environmental legislation in the 1970s changed this perspective. Specific compliance requirements suddenly demanded larger amounts of capital and greatly increased operating costs. Expanded potential liability and the enforcement of new, and many times confusing, standards, sometimes with retroactive requirements, demanded increased sophistication and brought concern about environmental issues to the highest levels of the corporate hierarchy.

Response to legal issues also required new approaches. Many traditional company lawyers failed in their counseling to understand that environmental legislation was social legislation and would be broadly interpreted. Some companies, recognizing the need for new skills, began to hire lawyers with experience in the new federal and state environmental regulatory agencies, whose advice was in turn shaped by the activism of the 1960s.

A major expansion of civil and criminal liability exposure in the 1980s including personal liability under federal, state and local laws, also became increasingly important 1/

MANAGEMENT TODAY

Peter Drucker and other management experts maintain that the key to management today is managing information.

1/ Tundermann, Personal Liability for Corporate Directors, Officers, Employees, and Controlling Shareholders Under State and Federal Environmental Laws, 31 Rocky Mountain Mineral Law Institute 2-1 (1986).

THE ENVIRONMENTAL FUNCTION

The assumption is that large staffs are not necessary in order to manage information. But many companies, even with large staffs, did not have then, nor do they have today, mechanisms to ensure that significant information is received at corporate headquarters and is immediately made available to decision makers.

This unavailability of significant information is exacerbated by many companies' efforts to decentralize. While decentralization is useful to reduce decisionmaking time and encourage entrepreneurship, the corporation in today's regulatory and litigation climate must have knowledge of potentially significant issues at the earliest possible time in order to avoid major problems.

The underlying assumption for effective environmental management must be: What you don't know will hurt you.

Obtaining this information and utilizing it effectively can be accomplished with minimal staff. Occidental is decentralized but has a centralized information base.

Furthermore, Occidental's professional corporate environmental and personnel safety staff consists of three people (the Vice President—Health, Environment and Safety; the Director—Environmental Affairs and Systems; and the former Director—Health, Environment and Safety, who is now retired but is consulting full-time with Occidental). In addition, Occidental has a lawyer in Washington who reports to the Vice President—Health, Environment and Safety in his capacity as Director—Regulation and Compliance, and to the Director—Regulation and Compliance, and to the Executive Vice President/Senior General Counsel in his capacity as counsel—Health, Environment and Safety, and a technical/legal assistant.

Notwithstanding this small staff, Occidental will match its knowledge of potentially significant issues and its ability to deal with those issues with that of any other large company.

ENVIRONMENTAL MANAGEMENT REPORT

THE OXY PHILOSOPHY 2/

Top management is strongly committed to and involved in the company's environmental management programs. Reporting is to an Executive Vice President and to the Environmental Committee of the Board of Directors. This committee has been in place since May 1981 as a result of a Board resolution and recommendations which arose from the settlement of a July 1980 Securities and Exchange Commission Order, which in turn was issued when Occidental tried to acquire the Mead Corporation in 1978. Occidental agreed to designate an independent member of the Board of Directors, an environmental official, and an independent consulting firm to prepare a report which would "recommend procedures to the full Board of Directors to ensure that Occidental will be in a position to disclose, in accordance with the federal securities laws on a complete, timely and accurate basis, all required information relating to environmental matters." 3/

Notwithstanding the strong Board and management support, Occidental's program would not have been possible if we

2/ For a discussion of environmental management systems, see Wilkenfeld, Managing Staff Functions in a Large Corporation, Management Review 41 (June 1986); Wilkenfeld, Management Systems for Minimizing Environmental Liability, 1 Toxics Law Reporter 290 (August 20, 1986); Friedman, Corporate Environmental Programs and Litigation: The Role of Lawyer Managers in Environmental Management; 45 Pub. Rev. 766 (December 1985); Friedman, Managing and Resolving Corporate Environmental Issues, 4 Environmental Forum 28 (February 1985); Friedman, Organizing and Managing Effective Corporate Environmental Protection Programs, 3 Environmental Forum 40 (May 1984); and Friedman, 60's Activism and 80's Realities, 2 Environmental Forum 9 (July 1983).

3/ See In the Matter of Occidental Petroleum Corporation, Exchange Act Release No. 16950, July 2, 1980.

THE ENVIRONMENTAL FUNCTION

had not been successful in minimizing "turf" issues. In reviewing corporate programs, it has been our experience that the greatest obstacle to effective and cost-effective programs is "turf."

Divisional managements have a deep distrust of corporate bureaucrats, whom they view as interfering with their business and, even worse, not understanding it. This reaction is in far too many cases well justified. Many corporations either were or are even now overstaffed, and staff have to justify their existence by at least showing they are doing something.

Efforts are underway to pare back corporate controls and allow divisions greater management freedom. This in turn generates an almost "revenge" mentality and a strong desire to "get back" at the corporation. Similarly, divisions are under cost pressure to reduce staffs.

Obviously, bloated staffs either in corporate or divisional headquarters are to be avoided. Similarly, even with reduced staff, old tendencies die hard and there is still too much management by committee. Perhaps the committee meetings might be smaller, since there are now fewer people to attend, but it would be far better to grant broader authority and encourage risk-taking rather than tie up scarce resources in needless paperwork and meetings.

HOW THE OXY PHILOSOPHY IS IMPLEMENTED

At Occidental, we were fortunate in avoiding these problems from the beginning. We are basically a new company without a history of "staff wars." When Dr. Armand Hammer, our Chief Executive Officer, took the company over in 1957, its net worth was only \$100,000. With rapid growth in the international oil and gas area, and limited domestic oil and gas operations, it expanded through primarily domestic acquisitions in a wide variety of areas to where today it is the twelfth largest U.S. corporation in terms of sales.

ENVIRONMENTAL MANAGEMENT REPORT

In essence, corporate headquarters has always functioned as the equivalent of a holding company with a very small corporate staff. The divisions, in turn, were given substantial leeway and encouraged to keep staff size down.

In the environmental area, it was not until 1978 that an individual was added to the corporate staff to develop a corporate environmental program. That individual, an experienced environmental professional with over 35 years' experience in Occidental's chemical operations and the predecessor chemical company, was not viewed as a threat. Rather, his role was to ensure that significant issues were identified by the divisions and brought to management's attention. He also reviewed divisional environmental programs to ensure adequacy and equivalence. As an environmental professional, he could work effectively with the environmental professionals and the management of the divisions, which at that time were only chemical, coal, international and domestic oil and gas.

In 1980-81, following an SEC settlement and the creation of an Environmental Committee of the Board, the Board and top management gave the corporate environmental department a mandate to see that independent assurances would be provided that the company was properly addressing environmental concerns and that systems would be developed and maintained to independently determine the status of compliance.

Recognizing that the divisions had been operating semi-autonomously in the environmental area with effective staffs, that mandate did not mean the growth of a massive corporate staff. Growth consisted of the addition of two professionals at headquarters. Instead, the corporate staff looked toward assuring that there were capable environmental professionals in the divisions, where the basic work was being done and should be done. Our role was really to assist rather than to replace or direct their efforts. The result was that jealousies and "turf wars" were rarely an issue. Clearly, the corporate staff was not large enough to take over for the divisions even if it wanted to. Similarly, the environmental professionals in the divisions could be assured of the necessary resources through the backing of the

THE ENVIRONMENTAL FUNCTION

corporate staff via a direct functional line of communication. Their managements, in turn, were aware of the mandates of the Board and corporate management.

Continuing dialogues were maintained with divisional managements and corporate staff to assure that they understood that they were not being undercut. Corporate staff, in turn, had the mandate that allowed full discussion with interested individuals in the divisions without being hampered by a rigid chain of command.

During Occidental's rapid growth over the last few years with the acquisition of IBP (beef and pork slaughtering), Cities Service (oil and gas) and MidCon (gas pipelines), each with different corporate "personalities," we met immediately with our counterparts in these organizations following the decision to merge and prior to actual closings, to acquaint them with our programs, and, above all, to assure both operating management and environmental staff that Occidental did not have a bureaucratic corporate staff that would interfere with divisional management. The results were that by the time of closing, transitions had been completed and the mentality of working together without "turf" issues in this area was cemented.

Obviously, environmental managers have to deal with the corporate "culture" as they find it. While the ability to develop strong divisional and corporate programs was aided substantially by our corporate culture and the awareness of management and the Board, particularly following the series of dramatically environmental incidents on the Niagara frontier, this does not mean that these programs are unique to Occidental. As discussed in the following, what is required are:

- regular, timely and uniform reporting from the operating line through senior management to the Board of Directors;
- prompt identification and resolution of environmental issues;

ENVIRONMENTAL MANAGEMENT REPORT

- establishment of preventive programs and procedures; and
- identification of developing issues or trends.

The key elements of the program are:

- a computerized, centralized information system (whether in a centralized or a decentralized management system);
- a facility assessment program;
- an internal planning document and timetable;
- a capital expenditure review system;
- a willingness to address problems once they are discovered; and
- a legislative and regulatory action program.

Note that each element of the program ties into at least one objective.

In these times of cost-consciousness, it has been our experience that these programs can save a corporation substantial sums, while keeping both corporate and divisional staffs to a minimum size.

Keeping staff to an absolute minimum is essential. To do this, we continually review job functions and program needs. For example, this past year the records administrator position was abolished and systems management was assigned part time to the Director—Environmental Affairs and Systems, based on improvements in the computerized data handling systems.

REPORTING

Each Occidental division must ensure reporting of environmental matters directly to the corporate environmental department, particularly "significant matters" and "excursions."

THE ENVIRONMENTAL FUNCTION

"Significant matters" are defined as events or situations which have resulted or may result in:

- (a) A variance in environmental standards or requirements affecting facilities or operations;
- (b) Adverse publicity or adverse community relations related to a specific company action or operation;
- (c) Notices of violation or advisory actions by regulatory agencies regarding environmental control matters or permit compliance;
- (d) Legal actions either by or against a division;
- (e) Identified risks to the environment;
- (f) Interference with continued production or marketing of any product because of environmental considerations;
- (g) Substantial incremental expenditures or loss of business related to events or situations caused by environmental considerations;
- (h) Problems for which the existing technical solution would impose a significant financial burden threatening the financial viability of the facility or operation;
and
- (i) Problems for which the staff cannot identify either remedial technology or cost of correction.

Events or situations are considered "significant" if they may result in capital expenditures or potential costs exceeding \$1 million. Any legal action under The Oxy Philosophy, by or against a division, and any item under Management, Reporting or Legislation and Regulations is considered "significant" without regard to potential costs and liabilities.

A "significant matter" arising from an accident or an incident must be reported immediately to corporate headquarters, while any other significant matter must be reported as soon as possible during working hours. The corporate environmental department then makes a recommendation to the

ENVIRONMENTAL MANAGEMENT REPORT

division and advises corporate management of the item and the recommended action.

All of these matters are reported in the computerized Environmental Action System data base.

THE COMPUTERIZED INFORMATION SYSTEM

This system is the communication mode and data base of most of the information needed in achieving all objectives.

In order to provide prompt and complete reporting, identify emerging issues, and provide information on the status of and method of ensuring action on agreed-on programs, Occidental has developed a management system based on a computerized data base known as the ENVIRONMENTAL ACTION SYSTEM (EAS) which has the capability to efficiently track all significant environmental incidents, reportable excursions from compliance requirements, and legal actions taken or pending, while providing uniform documentation available on a real-time, need-to-know basis at all levels of the corporation.

The EAS is a company-wide, on-line system residing in the company's mainframe computer. The EAS is programmed to allow development of a record on any specific issue (called a folio), which can be retrieved only by the responsible facility, industry group (or division) or by the corporate environmental and legal departments. The system can sort by any field or interval, provide prescribed format or ad hoc reports, update the status of records on a specific issue, and provide a history of all updates. It is managed and monitored by the Corporate Health, Environment and Safety Department.

The EAS has many benefits, allowing a small staff of five professionals in Los Angeles and Washington, D.C. to develop and monitor programs as well as enhance prompt and complete reporting of matters of significance to management. It is flexible enough to permit application in diverse industries such

THE ENVIRONMENTAL FUNCTION

as chemical manufacturing, oil and gas exploration, production and distribution, coal and non-coal mining, and beef processing.

At the facility level, there has been a substantial reduction in time spent generating paper and in telephone communication. One of the most important benefits is the requirement for clear identification of key information. Another critical element is the establishment of a work plan and timetable for each folio. This forcing of logical response identification in large measure is the reason for inclusion of the word "action" in the title.

THE PLANNING DOCUMENT

The planning document is considered a major element in Occidental's environmental program, since it contains the essence of the company's long- and short- (one year) term environmental strategy. It has as its primary objective the development of preventive programs and procedures based on identified issues and trends. It is essentially important when one considers the minimization of liability as a goal, rather than having a program which simply reacts to regulations and problems as they arise, as many companies still do. Occidental has found that it is more effective to take a proactive approach, in which emerging issues are identified and programs implemented to correct or avoid such issues.

The planning document itself is a simple compilation of items considered important based on assessment findings, entries in the EAS, and identified emerging issues in the legislative or regulatory arena, the press, or in the opinion of staff experts. It is not computerized, although the items could easily be entered into the EAS system.

The format includes the objective to be achieved, the approach to be taken in achieving the objective, the responsibilities and target dates for both the division(s) and corporate groups involved. In no case are the items under any of the headings more than 25 words in length. Most are five or ten. The

ENVIRONMENTAL MANAGEMENT REPORT

document is updated and circulated for review and comment by the divisions approximately twice a year.

Since this document is included in reports to senior management and the Board of Directors, this clear statement of identified longer-term issues and goals has developed into a major lever, forcing prompt action.

CAPITAL EXPENDITURE REVIEW

Review of all capital expenditure or sale of asset requests (Authorized for Expenditure, or AFE) for environmental effects is a preventive measure aimed at ensuring compliance with regulatory requirements and minimizing liability.

Early on, it was noted that it was necessary not only that identified issues are taken care of, but that the development of problems is avoided. To this end, the Authorization for Expenditure policy was amended to require that a health, safety and environmental review be conducted for any capital expenditure request requiring Board of Directors approval. These AFEs are also reviewed by the corporate staff prior to presentation to the Board. This is now being expanded to include reviews of AFEs approvable at lower levels by staff people at that level in the divisions. AFE requests cover expenditures for both the construction of new or the modification of existing facilities and the acquisition or sale of existing capital assets. Extensive checklists have been prepared for both types of AFEs.

The system has been used successfully in connection with several major acquisitions and planned construction problems. It has not, however, been a major source of paperwork nor resulted in the equivalent of massive Environmental Impact Reports (EIRs) or statements (EISs). Normally, all that is provided is a statement by the requestor that the environmental, health and safety implications of the project have been considered, or a brief statement laying out the implications and actions to be taken.

THE ENVIRONMENTAL FUNCTION

The corporate review of AFEs is done by both the legal and technical staffs, who have considerable experience in Occidental's industries and can either assess the project's human health and environmental considerations or know enough to discuss the project with the appropriate division people, requesting elaboration of the comments or modification of the project as appropriate.

Acquisition of capital assets that involve the purchase of land or manufacturing facilities usually also calls for site visits by corporate and/or division staffs. Very occasionally, consultants are used to assist in field evaluations. When facilities or whole operating companies are being purchased, they are provided with a copy of Occidental's checklist prior to the "due diligence" meeting on environmental matters.

LEGISLATION AND REGULATION

Monitoring of the legislative and regulatory arena is a never-ending process. Many people approach it with a sense of frustration, considering it too broad to handle and difficult, if not impossible, to affect. This need not be the case if the goals are considered to be the resolution of problems rather than the defense of current practices and, additionally, the early identification of probable future requirements for management and operating people.

To do this effectively requires recognized, professional environmental experts continually on the scene, with close, ongoing liaison with the operating divisions and with short lines of communication. Parenthetically, short lines of communication are very important in all aspects of the program, permitting prompt decisionmaking and action upon discovery of significant issues or items. The legislative and regulatory staffs do not have to be large. Occidental has one person with a technical assistant. Since this person has the expertise in the areas in question, with both a legal and a technical background, as well as credibility with government agencies and congressional

ENVIRONMENTAL MANAGEMENT REPORT

staffs, he does not have to spend time being briefed or returning for decisions on every point. These people also participate in the conduct of assessments.

OTHER ATTRIBUTES

An understanding of litigation and the administrative process is critical. The key staff at both corporate headquarters and the divisions have broad experience either in government or dealing with government agencies and the political process. In turn, they establish their credibility (integrity).

It is critical to know how to deal with enforcement issues and avoid enforcement problems. However, this must include a willingness to negotiate constructively, while sending a clear signal that one is ready and willing to litigate if necessary.

The need for assessments and action plans arising from assessments must be surfaced early and at levels where action can be taken. Action plans not so addressed may result in the proverbial "smoking guns."

The development of a means to identify emerging and future environmental issues and to coordinate overall responses when one or more than one division is involved is also critical. Occidental circulates a legislative and regulatory forecast and develops action plans based on this forecast. Occidental's short and direct lines of communication allow for quick responses.

REDUCTION OF LIABILITY EXPOSURE

The term "toxic torts" should be viewed generically. These torts are not significantly different from other types of product liability cases, but they do include new factual issues, large numbers of plaintiffs and, in the environmental area, they represent a potential major increase in liability exposure from traditional exposure to air, water, and waste. The programs

THE ENVIRONMENTAL FUNCTION

discussed in this paper are designed to avoid the underlying or potential causes of such cases before they require action.

The increased potential liability of directors, officers and senior managers must be recognized and minimized or avoided. The added duties imposed by recent environmental laws require consideration in every program element. 4/

There is greater emphasis today on legal controls. If you have made a decision to have an environmental program, or if you have identified a problem you have also made a decision to find a solution.

Note in Restatement of Torts 5/ that "compliance with a legislative enactment or administrative regulation does not prevent a finding of negligence where a reasonable man would take additional precautions." Also, it is generally held that corporate officers can be held vicariously liable for the conduct of subordinate employees, and either a purposeful failure to investigate or "deliberate ignorance" can be "knowledge" for purposes of criminal liability.

THE ASSESSMENT PROGRAM

The assessment program is a review function which, when properly conducted, has an effect on the achievement of all of the key elements mentioned earlier, in addition to a fifth provision of assuring management that there is ongoing independent review of the adequacy of programs and facilities. While this last item is important, the most valuable result of assessments is the frequent identification of issues which should be addressed by the facility. In many instances, these are not readily

4/ See Tundermann, supra.

5/ 2d Sec. 288c.

ENVIRONMENTAL MANAGEMENT REPORT

apparent to the facility staff because they are too involved in day-to-day operations or because the significance of the issues is underestimated. Another side-benefit is the increased awareness of the importance of environmental control by both the facility staff and the assessment team members as a result of participating in the assessment process.

Remember, at best, the assessment is only a "snapshot," and the findings must be translated into "actionable" items if the assessment is to serve its intended purpose. The findings must be distributed to those who can act on them, as well as to those who can evaluate their impact from different perspectives.

Because of the substantial diversity among Occidental's industries and the varied type of issues and organizational structures, corporate policy requires each division to develop a self-monitoring assessment program which meets at least the minimum criteria specified in the Assessment Program Guidance Document. The assessments are conducted by a team that includes members independent of the unit being assessed, usually from the division headquarters and frequently from environmental staffs of other facilities within the division, as well as representatives from the facility. As needed, an attorney either attends or is available to provide legal interpretations. A review of the report by counsel is helpful in ensuring that the reports clearly state the facts.

Members of the corporate staff observe the conduct of assessments on a "spot check" basis. This serves a dual purpose. First, it provides a double-check on the conduct of assessments, and second, it provides insights into issues which might have corporate-wide implications.

Reports of assessment findings, after review and acceptance by the facility management, are distributed to division management, with a copy to corporate headquarters for review and comment by the Corporate Health, Environment and Safety staff. The reports, along with any corporate comments, are

THE ENVIRONMENTAL FUNCTION

then distributed to the Environmental Committee of the Board of Directors and to the Legal Department for their review.

Findings of assessments frequently lead to inclusion of items in the environmental planning document.

It is important that assessment team members be well versed in the intricacies of environmental protection requirements and the unique features of the industry being assessed. This requires the ability to look beyond regulatory requirements and detailed checklists, although checklists are useful in ensuring completeness of coverage.

Care must also be taken to cover the "grey area" where environmental protection and industrial safety interface. Of particular importance is emergency prevention, preparedness and response plans for staff, facility and community protection. Assessment and all other environmental programs should recognize this and consider such impacts in their conduct. Occidental conducts safety and health as well as environmental assessments. Some divisions do them jointly, others separately.

As previously noted, an action plan is developed based on the findings. This plan includes an implementing timetable for completion of the action items. Each item in the action plan is entered into the EAS for tracking and as documentation that appropriate action is being taken.

In summary, it can be seen that in addition to checking on compliance, assessments tie into other program elements as well as help achieve corporate objectives by:

- identifying items for consideration for inclusion in the planning document;
- helping identify issues of legislative or regulatory concern;
- checking on the adequacy of programs and AFE considerations; and

ENVIRONMENTAL MANAGEMENT REPORT

documenting and providing management at all levels with a picture of the status of the facility.

In addition, the EAS is used to identify significant items for the assessment team prior to the assessment and to track plan items afterwards.

During the conduct of an assessment is an appropriate time to review facility programs for reducing effluents, emissions, and waste discharges, as well as programs for minimizing the use of pits, ponds, lagoons, and underground storage tanks. It is also appropriate to review and determine if installations made as a result of expenditures approved earlier meet the projected objective.

MANAGEMENT FOR THE FUTURE

A major objective in becoming aware of compliance issues is to have senior management recognize that environmental management includes the opportunity to reduce both present and future costs ("a profit improvement center") and that compliance is only a small portion of good environmental management.

The prompt resolution of compliance issues frees the manager from spending a lot of time on environmental issues, and allows this person to attend to the business of the company.

The need to take a system approach—to review process change in today's economy, not just a focus on permits, is another major objective in management for the future. Example: Not having to hire additional staff for the engineering department, but rather making better use of the existing staff.

INVENTORY EMISSIONS

If you know what is out there, you can develop the systems approach to reducing costs. Waste reduction is a good example.

THE ENVIRONMENTAL FUNCTION

Occidental Chemical Company has reduced hazardous waste landfilling by 96 percent.

The cost advantage in dealing with problems now, rather than in a much more costly manner of waiting until new regulations, etc, are promulgated, are summarized in the TV commercial which states "Pay me now or pay me later."

ENVIRONMENTAL RISK

Grover Wrenn, former head of Health Standards, OSHA, said, "Few companies have yet made the health, safety and environmental risks an integral part of their management." 6/

CONCLUSION

Compliance with the law is still critical for environmental management. Liability exposure is increasing, and with it the responsibilities of the environmental manager, particularly the manager who is also a lawyer, and of counsel. But, in the future, the challenge is to go beyond compliance, to institute systems to develop an inventory of materials disposed of into any media, and then to establish goals for the reduction of those pollutants; to effectively and efficiently deal with proposed legislation and regulations; and to reduce operating and administrative costs through a systems approach and long-range planning. These programs will not only be cost-effective, but will significantly reduce potential liability exposure.

The true test for the environmental manager will be to be socially responsible, to improve the corporate "bottom line," and to maintain compliance with both the law and corporate environmental policy.

6/ Business Week, October 7, 1985, p. 102H.



UNITED STATES SENTENCING COMMISSION
1331 PENNSYLVANIA AVENUE, NW
SUITE 1400
WASHINGTON, D.C. 20004
(202) 662-8800

William W. Wilkins, Jr. Chairman
Michael K. Block
Stephen G. Breyer
Helen G. Corrothers
George E. MacKinnon
Ilene H. Nagel
Benjamin F. Baer (ex officio)
Ronald L. Galner (ex officio)



December 5, 1988

MEMORANDUM:

TO: Commissioners
Staff Director
Legal, Research, Hotline and Drafting Staffs

FROM: Paul K. Martin *PK*

SUBJECT: Testimony and Written Submissions

Attached for your review is testimony from four witnesses who had not submitted written statements prior to the Pasadena hearing. Additionally, I am circulating public comment from the Association of the Bar of the City of New York and the Business Roundtable.

Finally, in my haste to organize the hearing I may have circulated an incomplete packet of testimony from the Environmental Protection Agency. I enclose the full submission now for your review.

Attachments

Testimony: Ivan P'ng; Eric Zolt
Robert M. Latta
Robert A.G. Monks
Charles Renfrew
Environmental Protection Agency

Public Comment: Association of the Bar of the City of New York
Business Roundtable

THE ASSOCIATION OF THE BAR
OF THE CITY OF NEW YORK
42 WEST 44TH STREET
NEW YORK 10036-6690

COMMITTEE ON CRIMINAL LAW

JED S. RAKOFF
CHAIR
180 MAIDEN LANE
NEW YORK 10038
(212) 510-7100

WILLIAM F. COSTIGAN
SECRETARY/TREASURER
180 MAIDEN LANE
NEW YORK 10038
(212) 510-7979

November 30, 1988

FEDERAL EXPRESS

Paul K. Martin
Communications Director
U.S. Sentencing Commission
1331 Pennsylvania Avenue, N.W.
Suite 1400
Washington, D.C. 20004

Dear Mr. Martin:

Let me once again thank you for your invitation to have a representative of the Association of the Bar of the City of New York testify at the Commission's second public hearing on organizational sanctions scheduled for December 2 in Pasadena. Unfortunately, it has proven impossible for any suitable member of the Association to go to Pasadena to testify. However, the Criminal Law Committee of the Association has carefully considered the Commission's draft materials on organizational sanctions and has prepared a letter briefly commenting on the proposals now before the Commission. I take the liberty of enclosing this letter, with the hope that it will be of use to the Commission.

Many thanks for your kind consideration.

Very truly yours,



Jed S. Rakoff

cc: Commissioner Ilene Nagel

THE ASSOCIATION OF THE BAR
OF THE CITY OF NEW YORK
42 WEST 44TH STREET
NEW YORK 10036-6690

COMMITTEE ON CRIMINAL LAW

JED S. RAKOFF
CHAIR
180 MAIDEN LANE
NEW YORK 10038
(212) 510-7100

WILLIAM F. COSTIGAN
SECRETARY/TREASURER
180 MAIDEN LANE
NEW YORK 10038
(212) 510-7979

November 30, 1988

United States Sentencing Commission
1331 Pennsylvania Avenue, N.W.
Suite 1400
Washington, D.C. 20004

Attn: Organizational Sanctions Committee

Dear Sirs/Madams:

We write on behalf of the Criminal Law Committee of the Association of the Bar of the City of New York to comment on the Discussion Draft of Sentencing Guidelines and Policy Statements for Organizations ("the Draft") prepared by the Commission's staff. The Association of the Bar of the City of New York ("the Association") is an organization of nearly 18,000 lawyers, most of whom practice in the New York City area. The Criminal Law Committee (the "Committee") is the committee of the Association having primary jurisdiction for reviewing and commenting on substantive developments in the criminal law. The Committee includes within its membership present and former prosecutors, defense attorneys, judges, and law professors.

The Draft proposes sentencing guidelines based on a model of purported economic rationality. That model treats corporate criminal transgressions as economic acts committed by individual agents of the corporation. Under the model, those corporate offenses, as opposed to the offenses of the individual agents, are redressed through the application of an economic formula based on the concept

loss" principal can in no way provide compensation for the societal costs of numerous corporate crimes, such as bribery, involving the integrity of the marketplace, or, such as obstruction of justice, where the ultimate monetary loss caused to the victim, if any, may be small. Such crimes when undertaken as part of a deliberate corporate policy or when facilitated by distinctive features of a particular entity's corporate climate are fairly perceived as corporate crimes distinct from the crimes of the individual agents and should therefore be redressed in a manner vindicating societal interests having no relation to the victim's loss.

Second, the Committee takes issue with the use of "offense multiples" as envisioned by the Draft. The Draft generally provides for the multiplication of the "offense loss" by 2.0 or 2.5, figures which can, in certain instances and within prescribed limits, be adjusted upward or downward. The Draft contemplates that the multipliers reflect, to a great extent, the difficulty of detection of the particular crime being punished, apparently on the theory that corporations will make economic calculations as to the probability of being caught. But the Draft fails anywhere to set forth an empirical basis for the multipliers chosen, thereby belying the economic premise of the model. (Indeed, it is impossible to believe, without supporting data, that crimes in which a multiplier of 2.0 is mandated -- i.e., private fraud offenses -- have under normal circumstances a 50 percent chance of detection.) The Draft's failure more fully to explain the choice of multipliers, and the improbability that they will approximate the detectability of the crimes punished, invites speculation that they serve some unstated goal unrelated to the

economic model. Such speculation only undermines the credibility of the sentencing process, whatever model is used as a basis for the guidelines.

Third, the Committee believes that the Draft creates a complex and perhaps unworkable sentencing structure that places inordinate burdens on the prosecutor, the probation department and the court. In many cases the loss caused to a victim -- the "offense loss" -- will not be susceptible of easy calculation, and the cost of enforcement will be virtually impossible to determine. As a result, the Draft appears to invite mini-trials on sentencing after a determination of guilt has already been reached. The prospect of elaborate fact-finding procedures at the sentencing stage, in which the prosecution bears the burden of proof, creates a disincentive to the prosecution of corporate crime that we do not believe was intended by Congress when it mandated the promulgation of sentencing guidelines. This is particularly so in cases ending in guilty pleas before the completion of the grand jury investigation and the consequent discovery of evidence related to loss, and in cases (such as environmental cases) in which the evidence of loss may be unrelated to proof of guilt and will therefore remain undisclosed in the government's pre-conviction investigation.

Finally, the Committee believes that the Draft inappropriately views probation as a sentencing tool to be used purely to further the economic goals of the monetary sanctions provisions of the Draft. The Draft thus inadequately considers the potential uses of probation in furthering the traditional purposes of criminal sentencing discussed above. Nevertheless, the Committee has been



unable to reach consensus on the alternative proposal on organizational probation drafted by Professors Coffee, Gruner and Stone. In particular, some members of the Committee have expressed concern about the extent to which that proposal provides for ongoing post-sentencing investigations into underlying criminal activity. They argue that such investigations undercut the important goal of finality in the criminal process. Despite these reservations, the Committee as a whole believes that the probation guidelines contained in the alternative proposal provide a basis for further study of the possible uses of corporate probation as an alternative to monetary sanctions, and that such study is warranted.

We thank the Commission for the opportunity to comment on the Draft and hope that our comments will prove useful.

Respectfully submitted,

Committee on Criminal Law
Jed S. Rakoff

Hon. Dynda L. Andrews
William I. Aronwald
Barry A. Bohrer**
David M. Brodsky
Don D. Buchwald
Zachary W. Carter
Pamela R. Chepiga
Sheldon H. Elsen
Michael S. Feldberg
Jack S. Hoffinger
Hon. Richard D. Huttner
Frederick J. Jacobs
Nikki Kowalski

Harlan A. Levy
Jeffrey E. Livingston
Prof. Peter S. Lushing
Lawrence M. Martin**
Gary P. Naftalis
Hon. Harold J. Rothwax
John C. Sabetta
Minna Schrag
William J. Schwartz*
Paul E. Summit
Howard S. Sussman
Philip L. Weinstein
Dennison Young, Jr.
Lawrence J. Zweifach

*Chair of subcommittee on sentencing and primary drafts person of this letter.

**Member of subcommittee on sentencing.

BFGoodrich

The BFGoodrich Company
3925 Embassy Parkway
Akron, Ohio 44313

John D. Ong
Chairman of the Board

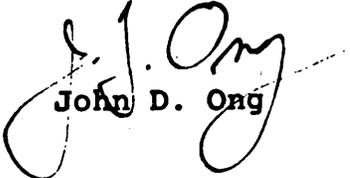
November 30, 1988

The United States Sentencing Commission
1331 Pennsylvania Avenue, N.W.
Washington, D.C. 20004

Dear Sirs:

The Business Roundtable is pleased to take this opportunity to comment on the Discussion Materials on Organizational Sanctions. I submit the attached comments on behalf of the Roundtable as Chairman of its Antitrust and Government Regulation Task Force.

Sincerely,


John D. Ong

(a) A business organization is a single legal entity, but it may employ tens of thousands of people and be owned by tens of thousands of largely different people. A small number of employees may engage in prohibited conduct, but punishment will be imposed on an organization owned by innocent shareholders ^{1/} and may indirectly affect other innocent employees, suppliers, customers and indeed entire communities. To complicate matters further, the innocent people who suffer when the organization is punished may not have had any connection with it when the offenses were committed.

(b) Predictions about the deterrent effects of criminal penalties on individuals are not necessarily valid when applied to organizations. It is particularly naive to assume that corporate employees, who contemplate a violation of law, try to balance anticipated incremental profits against possible penalties discounted by the likelihood of non-detection. They are far more likely to balance individual benefits (possible promotions or just an easier life) against individual sanctions, inside or outside. It is even more

^{1/} We assume that the Commission was mindful of this problem when it asked for comments on whether different rules should apply to publicly held corporations and closely held corporations. We do not believe a rigid distinction is appropriate, but investors in publicly held corporations are more likely to be wholly innocent of wrongdoing.

inappropriate to base an entire scheme of criminal penalties on this unrealistic model of deterrence, when the penalties will be borne by people (such as stockholders or employees) who have no mens rea at all.

(c) Many criminal statutes that apply to organizations are not intuitively obvious; an employee's normal human instincts will not necessarily produce the right answer, and the burden of education and supervision may be considerable. Criminal penalties should theoretically stimulate an appropriate level of education and supervision. 2/ Some regulatory crimes are so new and experience so sparse, however, that it is difficult to know what the appropriate levels of education and supervision may be. This also has an impact on the accuracy of any deterrence model, and raises the further question of whether it is fair to punish honest mistakes almost as severely as genuine malfeasance or negligence. Moreover, whatever the level of

2/ Although one objective of corporate penalties may be to encourage compliance programs, corporations may be unable to introduce evidence about their efforts -- even if the behavior at issue was expressly prohibited. Evidence that employees violated corporate policies may not be admissible in a criminal prosecution of the corporation. See United States v. Basic Construction Co., 711 F.2d 570 (4th Cir.), cert. denied, 464 U.S. 956 (1983); see also Bloch, Compliance Programs and Criminal Antitrust Litigation: A Prosecutor's Perspective, 57 Antitrust L.J. 223 (1988).

corporate deterrence efforts, it is important to recognize that unscrupulous employees are found in all walks of life, and that neither corporate managers nor government officials can strictly guarantee the honesty of their employees.

(d) Because of these factors, criminal law violations may or may not be intentional and culpable from an individual point of view; they may or may not reflect negligent oversight; and the people who ultimately will bear the burden of the fines are likely to be entirely innocent. These issues of moral culpability cannot be ignored under a statutory mandate which requires the Commission to consider "just punishment" as a pertinent factor, and there is no simple economic equation that will answer the hard questions.

(e) In discussing the special characteristics of corporations, we do not mean to suggest that it is inappropriate to impose criminal penalties on corporations. Specifically, we support a coordinated system of civil and criminal remedies that is designed to deprive corporations of any gains derived from illegal activity. We do suggest, however, that organizational guidelines be flexible enough to allow for consideration of these special factors that affect culpability in individual cases.

II

Comments on the General Approach

(a) Introduction

The Guidelines for Organizational Sanctions are premised on an economic model, which generally calls for sentences that are far higher than those imposed today. In this respect the organizational guidelines differ markedly from the individual sentencing guidelines, which were generally designed to codify prior mainstream experience. The individual guideline sentences were designed to narrow the spread between extremes, but not to increase sentences systematically on the basis of some general theory. ^{3/} The stated justification for a different approach to organizational sentencing is passage of the Sentencing Reform Act of 1984, ^{4/} with subsequent amendments:

. . . although the Act did not change authorized imprisonment levels for federal offenses, it did make other substantive changes in criminal sentences, by generally raising and restructuring statutorily authorized fine levels ^{5/}

^{3/} Actual time served may increase somewhat because of the abolition of parole.

^{4/} Chapter II of the Comprehensive Crime Control Act of 1984, Pub. Law 98-473 (Oct. 12, 1984).

^{5/} Parker, Criminal Sentencing Policy for Organizations at 17 (Sentencing Commission Staff Working Paper, May 1988). See also id. at 28, quoting the Senate Report on the Act to the effect that the new fine levels are "considerably higher than those generally authorized by current law."

Most significantly, Congress has now authorized maximum fines of up to twice the pecuniary gain or loss caused by an offense.

There is a big difference, however, between Congressional authorization of a maximum fine measured by gain or loss and adoption by the Commission of a general principle that all fines should be so measured -- particularly when, as discussed below, the Guidelines then apply multipliers to account for the risk of non-detection. The authors of the current draft cannot fairly claim that Congress has sanctioned a uniform application of their general economic approach (although Congress has not forbidden it either). The point of this criticism is not that the draft's economic approach is wrong for all cases; the point is that grave injustice can result in some cases, and that therefore the Guidelines should accommodate greater flexibility.

We believe that it should be tolerable to permit greater flexibility in organizational sentences than in individual sentences. We recognize that Congress was concerned about inexplicable disparities in sanctions for similar corporate crimes, ^{6/} but nevertheless the need for apparent uniformity in this area is far less compelling than it is when jail sentences are involved.

^{6/} Id. at 29.

(b) The Economic Model

The economic rationale for the draft guidelines is set out most clearly in the accompanying Working Paper by Jeffrey Parker, the Deputy Chief Counsel of the Commission, and these comments therefore refer extensively to that Paper. It summarizes the guiding theory as follows:

In its simplest form, the theory specifies an optimal penalty equal to the total external harm or loss caused by an offense (including enforcement costs), divided by the probability that the offense would be detected and punished. ^{7/}

Put another way, the social loss threatened by the offense is multiplied by a factor to account for the risk that the crime will not be detected and punished. There are complications both in the computation of the loss and the multiplier, which will be addressed later, but we first should consider how well this basic formula squares with fundamental principles set forth in the Sentencing Reform Act. As the Working Paper recognizes, Section 3553(a) of the Act (18 U.S.C. § 3553(a)(2)), identifies the "four basic purposes of criminal sentencing -- just punishment, deterrence, public protection, and rehabilitation." ^{8/} We will focus on the first two factors

^{7/} Id. at 3.

^{8/} Id. at 19.

because rehabilitation and public protection (by locking up offenders) are not meaningful considerations in the present context. The concept of compensation for victims is meaningful, however, and will be separately considered.

(1) Just Punishment. This factor involves consideration of the seriousness of a crime and the degree of moral culpability. The basic Guideline formula, which focuses on the threatened harm, may in theory provide an appropriate measurement of seriousness for many corporate crimes, but it has very little to do with moral culpability. In the first place, as we have already explained, the people who bear the brunt of the penalties typically have no moral culpability whatever. Moreover, as the Working Paper admits, a significant number of corporate prosecutions involve offenses by lower-level employees for which the corporate entity is vicariously and strictly liable. ^{9/}

The Working Paper makes a strained attempt to tie its recommended formula to moral culpability by invoking the multiplier:

By choosing an offense with a lower probability of detection, or taking actions to reduce the probability of punishment (e.g. concealment, obstruction), the offender multiplies the offense's potential

^{9/} Id. at 7, contrasting federal criminal law with "the prevailing state law rule."

for unredressed harm to society, and for that reason the conduct is blameworthy and deserving of a higher penalty. 10/

The Working Paper assumes that the people who pay the penalty have an actual intent to violate the law or to conceal illegal conduct, which is obviously not the usual case. In a corporate setting, acts of concealment or obstruction by the perpetrators are usually directed at corporate management in the first instance, because renegade employees fear the internal consequences of their violation of company policy. Their actions may also reduce the risk of punishment by the government, but it is perverse to claim that victimized shareholders should therefore be penalized more severely. This is not just a rhetorical quarrel because the draft Guidelines themselves provide for an increase in the multiplier for conduct that makes detection more difficult. (Guideline § 8B3.1(b)(1)) If multipliers are based on the probability of detection, it means that a few corporations will bear the entire loss caused by the acts of many violators.

It is similarly perverse to claim that moral culpability is increased to the extent that people commit offenses with a low probability of detection and punishment. That low probability may simply reflect the fact that there is

10/ Id. at 44.

very little societal interest in the enforcement of a particular statute, and that it is generally ignored. Low incidence of punishment may well be associated with low moral culpability. By the logic of the Working Paper, it is more culpable to run a stop sign on a deserted county road at midnight than it is to run a stop sign in mid-Manhattan at noon.

(2) Deterrence. The Working Paper contains an extended discussion of the reasons why punishment based on harm provides more accurate deterrence than punishment based on unjust enrichment. 11/ This all may be true as far as it goes, but the discussion is incomplete insofar as it applies to organizations.

It is overly simplistic to assume that corporations respond only to economic incentives just because they are organized to serve an economic function. The Working Paper states that "it is unlikely that business organizations have any non-financial interest that is powerful enough to drive an effective penalty system." 12/ Non-financial incentives may not "drive" corporate compliance, but they still make a powerful contribution and it is wrong to ignore them altogether.

11/ Id. at 35-42.

12/ Id. at 61.

It is, frankly, ridiculous to assume that most business people make a cold-blooded cost-benefit calculation when they decide whether to comply or not to comply with the law. The overwhelming majority are law abiding, like everyone else. The principal challenge for a corporate compliance program is to make sure that employees understand what the law requires, and compliance programs do not ignore laws just because the likely penalties are small. Corporate crimes continue to be committed because no organization staffed by human beings can do a perfect job of education and supervision. The penalties that most effectively provide an added incentive are those directed at morally culpable individuals, not those directed at the corporate entity.

Moreover, it cannot be assumed that corporate sanctions, based on a cost-benefit calculation, will necessarily ensure the appropriate level of supervision. They may in many cases, but the correspondence is not exact enough to justify draconian fines or the corporate equivalent of capital punishment -- irrespective of culpability -- simply because that is the outcome of a cost-benefit calculation. 13/

13/ As will be discussed in greater detail elsewhere, the Working Paper is not troubled by the prospect of corporate bankruptcy if it results from imposition of an "optimal" fine, id. at 49-50, 60.

The draft does not seem to recognize the practical complexities involved in corporate compliance efforts. There are some laws that require a company to maintain certain records or to take certain affirmative steps in the ordinary course of business. It may be relatively easy to set up a management system to ensure compliance at a predictable cost. There are other laws, however, that are directed at activity outside the ordinary course of business -- they are prohibitions rather than affirmative commands. Antitrust laws are a good example. Compliance is not assured by a set of working procedures, which management can supervise in detail; compliance can at best be fostered by educational efforts, but detailed supervision is practically impossible. From the corporate standpoint, violations can in a very real sense be unexpected and unintended. The draft Guidelines do provide for a decrease in the applicable multiplier to recognize corporate compliance efforts (§§ 8B3.1-3.2), but the potential offset is not clear enough or large enough to provide adequate flexibility -- particularly when civil remedies are also available.

In addition, a multiplier based on the incidence of prosecution may have perverse effects on deterrence. (We have already discussed its incongruity as a measure of culpability.) From the standpoint of the actor, it may be appropriate to adjust penalties upward in a systematic way to

correct for the risk of non-detection. But, organizational sanctions are not primarily intended to deter actors; they are rather designed to encourage adequate supervision. It is not self evident that corporate compliance efforts should -- with other factors constant -- be focused on areas where prosecutions are rare. Moreover the likelihood of internal detection and correction does not necessarily correspond to the likelihood of external detection and punishment. The point, once more, is that an economic model cannot capture the complexity of the problem.

Finally, of course, in virtually all cases the deterrent effect of corporate fines is blurred by the fact that neither the (arguably) culpable actors nor the (arguably) negligent supervisors will pay them -- wholly innocent shareholders will. A basic assumption of the deterrence model is not satisfied, and this is yet another reason why the economic model should not override sound judicial discretion.

(3) Compensation of the Public for Economic Harm.

The Working Paper endorses a "broad concept of social compensation," and asserts that:

the costs of crime and crime control are minimized when offenders are required to compensate society for the full measure of harm from offenses, including enforcement expenditures, as adjusted to reflect the

chances that an offender may escape punishment. 14/

We do not quarrel with this statement as far as it goes, nor do we quarrel with the general proposition that fines based on potential harm more accurately accomplish the stated objective than fines based, say, on potential unjust gains. 15/ Again, however, we believe that the proposed formulas do not work well in all cases.

It is important to remember that the recommended Guideline fines will be levied in addition to civil penalties. There is provision for Consideration of Collateral Civil Penalties and Disabilities (§ 8C5.5), which can result in an upward or downward adjustment, but only if there is reason to believe that the collateral penalties will deviate from the "standard level." It is safe to assume, then, that the total penalty will almost invariably be some multiple of the potential harm caused by the offense.

We will leave aside the very real problems associated with a calculation of potential harm, particularly where the harm consists primarily of an enhanced risk of untoward

14/ Id. at 34.

15/ In some cases, fines based on unjust enrichment may be more appropriate, and the courts should be given discretion to impose them.

consequences. We will rather focus first on the potential harm caused by purely inchoate offenses. The Guidelines provide (§ 8B1.1(a)(2)(B)) that the court should

consider both losses that actually occurred and losses that were (a) intended and probable consequences of the offense, or (b) reasonably certain to occur, but for the fact that the offense was not completed because of circumstances beyond the defendant's control

The accompanying Commentary states that this concept is adapted from the Guidelines applicable to individual offenses. There is a real question, however, about what is "intended" in an organizational setting when purely regulatory crimes are involved. There are also problems if a court focuses instead on the "reasonably certain" alternative. Perhaps an individual should not benefit from a purely fortuitous frustration of his scheme, but what about innocent people whose livelihood depends on a corporation? Suppose, for example, that a disloyal corporate employee embarks, secretly and contrary to company instructions, on an illegal course of conduct that over time could cause severe public harm. The employee's primary motivation is to avoid effort, but the conduct also saves some money for the corporation. The conduct is discovered purely fortuitously in the first instance by someone outside the corporation and the employee is fired or transferred before any material harm can be done. Should the corporation pay a fine based on the full potential loss, with a multiplier?

It is no answer to say that a court can deviate from the Guidelines in an extreme case like this. A large number of corporate offenses are close to the hypothetical, and the principles set out in these draft Guidelines may only be appropriate in rare situations. The appropriate sanctions for complex organizations may be more complex than the Guidelines recognize.

Another difficulty is that application of the Guidelines may call for penalties that are beyond the capacity of a defendant to pay. Multipliers based on "indirect damages," "probable consequences," or "threatened consequences" can increase the penalties to extraordinary levels. The comments in the Working Paper advocate a rather ruthless approach in these circumstances:

. . . it seems to me that forced liquidation (or reorganization) is the appropriate solution. At least then the assets will go to the highest bidder, and society will have minimized its losses, which seems preferable to allowing the continued operation of an organization that by definition is a net social burden, having created more loss than it can recompense. 16/

The resulting harm to shareholders is never mentioned, and the harm to innocent employees or customers is dismissed with a wave of the hand:

16/ Id. at 60.

Even though the consumers and employees may not have been involved in the offense, they can hardly justify a continuation of positions based on criminality. 17/

In other words, just because a company cannot pay a fine that is based on an imperfect economic model 18/ -- which may duplicate civil liability -- a court should conclude that the company is a "net social burden" and that its customers and employees owe their positions to "criminality." This is simply absurd.

(c) Non-Monetary Sanctions

The Roundtable believes that the draft Guidelines on non-monetary sanctions like probation (§ 8D2.1) are sound and appropriate. We share the reservations expressed in the Commentary and the Working Paper 19/ about the utility of probationary remedies in most cases. To the extent that the alternative Draft Proposal 20/ takes a more expansive view of the remedy, we urge that it be rejected.

17/ Id. at 50.

18/ In addition to the imperfections set out above, the economic model may also be incomplete because destruction of a company could have an adverse effect on competition and consumers.

19/ Id. at 30-31, 60,65.

20/ Coffee, Gruner & Stone, Draft Proposal on Standards for Organizational Probation (July 1988).

The shortcomings of corporate probation are illustrated by an aberrant recent decision. A federal District Court in an antitrust case recently sentenced the Allegheny Bottling Company to 1,095 days in "prison" and then suspended the sentence, placed the company on probation, and ordered four senior executives (including the president) who had not been personally involved in the antitrust offenses to perform 40 hours per week of community service for up to two years. 21/ The judge indicated that he could enforce the "prison" sentence by padlocking the doors of Allegheny's plant, but instead required probation and community service. Even the prosecutor expressed surprise. 22/

The executives who are required to perform community service were not involved in the illegal conduct and some were not even employed by Allegheny at the time of the violations. Allegheny is not a large company, and its operations are likely to be impaired if four senior executives must take 40 hours per week away from their jobs. It is hard to see what public purpose is served by a sentence of this kind.

21/ United States v. Allegheny Bottling Co., 55 BNA ATTRR 586 (E.D. Va. Sep. 9, 1988).

22/ Wash. Post Sept. 1, 1988, D-1.

As a condition of probation, a judge could theoretically appoint a probation officer to supervise a company's compliance programs and operations. This kind of supervision, however, is obviously outside the experience of the average probation officer, and even a specially designated officer is unlikely to have the expertise of the company's own management. Moreover, probation should not be necessary except in the most extraordinary cases that the Guidelines recognize. As part of a sentence on a corporation, a court can require the adoption and implementation of specific compliance programs. In addition to prohibiting certain conduct, the court can require certain affirmative steps, coupled with periodic reporting and open access. Such an order would not require supervision by a probation officer since the court presumably has sufficient authority to enforce its order. The penalties for contempt are severe and personal. It is therefore not clear that probation would add anything to the court's existing powers.

(d) Specific Examples of the Need For Flexibility

The deficiencies in the economic model that animates the Guidelines have practical, not just theoretical, significance. Consider, for example, the Federal Food, Drug, and Cosmetic Act, 21 U.S.C. § 301 et seq. The courts have interpreted the Act to impose a strict liability standard on

corporate officers, 23/ which means that corporations are likely to be held criminally liable without a showing of culpable intent or, indeed, even a showing of negligence. It is sufficient for liability if a corporate official (or the corporation itself) had the authority and ability to prevent the violation and failed to do so. The only available defense would be an affirmative showing that responsible officials could not possibly have known about the violations and were thus powerless to prevent them. This obviously can create a potentially serious problem for large corporations where the actors directly responsible may be separated by several layers of authority from top management.

Despite the broad authority conferred by the statute, there are few reported cases, which indicates that prosecutors exercise discretion to avoid unjust results and that many cases are settled before trial. There are examples of plea agreements where the fines were relatively small. 24/

23/ E.g., United States v. Park, 421 U.S. 658 (1975).

24/ E.g., United States v. Smith Kline Beckman Corp., et al. (E.D. Pa., Crim. No. 84-00227), reported in May 1988 FDA Consumer at 39 (\$1000 fine suspended, community service and \$100,000 contribution to civil program); United States v. Bueno Foods Old Mexico Brand, Inc., et al. (W.D. Tex. Crim. No. EP-86-CR-08), reported in Feb. 1988 FDA Consumer at 35 (\$6000 fine).

A rigid application of the proposed Guidelines for these offenses (§ 8B2.6) would substitute a mathematical calculation for the sound discretion that has obviously prevailed up to now. Moreover, if the draft Guidelines are adapted, there is a risk that the previous reluctance of prosecutors to take advantage of a particularly harsh statute could be invoked to justify application of a higher multiplier.

Several federal environmental laws are also virtually strict liability offenses. For example, courts have held that under the Resource Conservation and Recovery Act, 42 U.S.C. § 6928(d), which prohibits the "knowing" disposal of hazardous waste, it is no defense to claim that the defendant did not "know" that the wastes were hazardous or that disposal required a permit. ^{25/} Corporations are exposed to criminal sanctions for inadvertent discharges of infinitesimal quantities of material. Harm-based fines should theoretically be small in these situations, but the application of multipliers on top of civil remedies can lead to unjust results. Moreover, the Guidelines can be criticized -- and already have been criticized -- for undue leniency when flagrant offenses are treated substantially the same as inadvertent ones. There is

^{25/} See, e.g., United States v. Hayes International Corporation, 786 F.2d 1499, 1503 (11th Cir. 1986).

simply not enough experience with these new varieties of regulatory "crime" to establish principles for sentencing.

III

Concluding Recommendations

We recognize that it is not useful simply to criticize the approach in the draft Guidelines, and that there is some obligation to advance acceptable alternatives. Accordingly, we offer the following affirmative suggestions.

(a) Penalties for organizational offenses do not have to be quantified with the same mathematical precision as those for individual offenses. Many organizational offenses involve no morally culpable conduct at all, and civil remedies are far more significant than they are for crimes committed by individuals. We doubt that apparent discrepancies in corporate fines offend the communal sense of justice, and threaten disrespect for the law, to the same degree as apparent discrepancies in jail sentences.

(b) It is a mistake to key punishments to purely economic concepts like magnitude of harm and probability of detection. We would not reject the economic model altogether; like all economic models, it can provide useful information, but it is no substitute for individual judgment in individual cases. A court should have the latitude to weigh, as appropriate, additional factors like the nature of the conduct,

(d) We believe that from the perspectives of deterrence and just punishment, the most significant criminal penalties should be imposed on the individual corporate employees who are actually responsible for the unlawful conduct and who had the actual intent to violate the law, if such intent is required. In many cases the corporation that employs these individuals is more a victim of its employees' conduct than a participant; much of the illegal conduct is undertaken in contravention of express corporate policy. Consistent with this view, we also believe that it would be appropriate for the Guidelines to provide that if fines are imposed on individuals who have violated the law intentionally, the fines must be paid by the individual without assistance by their employer.

(e) We would recommend that the treatment of organizational penalties for Antitrust and Securities law offenses, contained in the first set of Guidelines, (§ 2R1.1), be revisited in light of the comments on this draft. The existing Guidelines for these offenses are not consistent with the current draft, much less with any revised version that might emerge. They provide for multipliers of two to five times estimated damages, and single damages are arbitrarily estimated to be 10% of the total selling price. Therefore, the recommended fines amount to 20%-50% of the total volume of commerce! These fines would be imposed in addition to the existing treble damage remedy available to private antitrust

plaintiffs, and private suits invariably follow if defendants appear to be funded. 26/

The Commission has invited comments on how civil and criminal penalties should be coordinated. In our view, the confluence of civil and criminal antitrust penalties results in potentially excessive antitrust penalties. The consequence of the multipliers for the criminal penalties and treble civil damages is that the defendant could pay fines and damages totalling eight times the overcharge. This is clearly a disproportionate effect.



Thomas B. Leary
Counsel for The Business Roundtable

51181/56950

26/ See Report of the American Bar Association Section of Antitrust Law Task Force to Review Proposed Legislation to Repeal or Modify Illinois Brick, 52 Antitrust L.J. 841, 863-68 (1983).

MR. CHAIRMAN AND MEMBERS OF THE COMMISSION:

My name is Charles Renfrew. I am pleased to have the opportunity to comment on the Discussion Materials on Organizational Sanctions. (July 1988)

My professional experience in the law has been varied. I have been a private practitioner, a lecturer at law school, a federal judge and Deputy Attorney General of the United States. Presently, I am a Director and Vice President of Chevron Corporation, responsible for its legal affairs. The views I express today, however, are solely mine and based upon my experiences which have given me three different perspectives of organizational sanctions. One, from the perspective of a federal judge who has imposed such sentences; two, from the perspective of Deputy Attorney General who had supervisory responsibility of federal criminal law enforcement and had the Director of the Federal Bureau of Prisons reporting to him; and, three, from the perspective of one who is an officer and director of a large corporation operating in some 100 countries and charged with the responsibility of establishing educational and compliance programs to ensure compliance with all of the applicable laws and regulations governing its operation.

Anyone who has given serious consideration to the problem of sentencing knows what a profoundly difficult job it is. The Commission is to be commended for the tremendous job it has done to date. The economic model on which the Discussion materials are based represents a new perspective and is a most thoughtful and useful analytical tool.

While imposing sentences, I felt the most appropriate sentence was the

least restrictive, consistent with public safety and which did not undermine the seriousness of the offense. There appears to be a consensus that in the United States, longer prison terms are given and for more offenses than in any other western country. Nor is there any data of which I am aware that the length of a particular sentence is a greater deterrent than the certainty of apprehension, prosecution and conviction of a crime.

I hope that the Commission with its precise formulae and mathematical certainties does not disagree with the approach I followed.

In any event, because the sentencing reforms contemplated by the Comprehensive Crime Control Act of 1984 were not in effect during the time I was on the Bench, I developed several personal practices which assisted me in carrying out that awesome and discretionary responsibility. I mention these practices which are not directly relevant to the subject of this hearing to indicate my concern for the responsibility of sentencing and my efforts to exercise that responsibility in the most consistent and rationale way possible. This might give the Commission some better perspective with which to view my testimony.

Each year I was on the Bench I visited a federal prison and spent from two to three days there. I observed classification, disciplinary and parole hearings, observed educational, substance abuse and vocational training programs, and spent a great deal of time talking with prisoners (including those I had sentenced) and staff. It gave me a better sense of that institution's programs and the nature of its prison population. This was helpful in recommending to the Bureau of Prisons, which institution I believed a particular defendant should be sent to.

Since Rule 35 of the Federal Rules of Criminal Procedures permitted a sentence to be modified within 120 days, I reviewed sua sponte each sentence I imposed after 100 days to see whether upon reflection I felt it should be modified. In this connection if the defendant had been sent to an institution I called that institution and talked to the defendant's case worker to learn how the defendant was adjusting to prison and what his or her attitude was. On a few occasions, I did modify a sentence.

For each defendant either on parole or probation, every three or four months I received a written report on that defendant and that defendant and the responsible parole or probation officer came to my chambers to discuss how that person was doing on parole or probation and what could be done to make it more effective.

The principal reasons for punishment have often been identified but the application of these reasons to the facts of a particular case are often unclear. Is the principal reason for punishment deterrence? Is it rehabilitation? Is protection of the public the main goal? Are we trying to provide compensation to the victim or is punishment an expression of society's outrage at the nature of a specific criminal offense? In actual cases, the unstated reasons for a specific punishment being meted out may vary greatly depending on the facts.

Another uncertainty that I faced as a district judge was to consider what effect the sentence that I handed down would have. One of the burdens of the sentencing responsibility is that the judge never knows whether the purposes

of the sentence are appropriate, let alone whether the purpose will be achieved. In this respect, over 14 years ago I imposed one of the first "alternative sentences" in a white collar crime situation. I required each of five corporate executives convicted of conspiracy to fix prices in the paper label industry to speak on 12 occasions to business or civic groups about their involvement in the case and to make written reports about each presentation. The goal was to see if a more effective deterrent could be obtained. In addition, I required a corporate officer of each corporate defendant to submit an annual written report of that Corporation's antitrust compliance efforts and to come to court to be available for questioning about the program.

I then surveyed persons who heard the talks and other members of the Bench, Bar, academic and business communities to determine what effect they thought the talks had had. I prepared a law review article based upon my efforts to determine the efficacy of the sentence. My efforts were then the subject of criticism by Donald Baker, then head of the Antitrust Division of the Department of Justice, Alan Dershowitz, Arthur Liman and Stanton Wheeler (see 86 Yale Law Journal, 1977 P. 589 et seq.)

These crude efforts on my part preceeded the very sophisticated and comprehensive draft guidelines of this Commission. It is to the draft of Sentencing Guidelines for organizations that I now turn.

The draft relies primarily on monetary sanctions. The first factor to be considered is the total harm or potential risk of harm that could occur. Once this factor has been reduced to a monetary value, it is subject to a multiplier, "the offense multiple", which is based on the difficulty of detecting

and punishing the wrongdoer. The multiplier increases in proportion to the difficulty of detecting the crime and punishing the wrongdoer. Finally, enforcement costs are added to arrive at "a total monetary sanction."

The premise underlying the Guidelines and the formula for monetary sanctions is that businessmen, in making decisions, approach all problems as "economic man". In other words, they make a cool, calculated decision based on the potential monetary profit or what they stand to gain, as offset by the adverse consequences — such as punishment for a criminal offense — that may flow from their decision.

My experience leads me to question whether economic motivation is sufficiently universal to cover all criminal behavior. Even corporations which are organized to make profits, respond to non-profit incentives, and to ignore them would be a mistake. Even if this premise is appropriate, when dealing with an organization where the culpable individual may have used individual gains or benefits as measured against individual sanctions, is it realistic to assess the criminal penalty against the corporation measured by some "offense loss", a concept never considered by the culpable persons? In order to serve as an effective deterrent, should the punishment not bear some relationship to the motivation which lead to the criminal activity? Greater incentives for corporate educational and compliance programs should be made.

The guidelines also fail to distinguish between the types of organizations which may be involved. A small partnership, a sole proprietorship or a mafia family operate differently than a Fortune 500, publicly held corporation. The consequences and the appropriateness of any sentence may vary, depending upon the nature and type of organization involved.

The problems of individual motivation are compounded when dealing with a large publicly held company. Such an enterprise may have tens of thousands of employees that are engaged in an enormous number of different activities. The laws and regulations that apply to such a company's activities seem almost endless. If one or more employees transgress the law, the corporation, through the doctrine of respondeat superior, is held responsible.

Respondeat superior, of course, normally applies to civil matters. The basic idea is that the employer or the corporation should be responsible for the acts of his agent. If the agent has ostensible authority and has acted wrongfully, the corporation is held strictly accountable for what happened.

The idea behind punishing a corporation for criminal misconduct is essentially the same: The corporation should be held strictly accountable for the criminal business actions of its agents or employees. It is important to consider, however, that the legal definition of virtually every serious crime includes an intentional element: The agent or employee must have acted willfully. It seems to me that, because of this intentional element, we should be cautious, for purposes of punishment, in imputing the criminal act of the agent or employee to the entire corporate structure. Moreover, many organization offenses involve no morally culpable conduct on the part of the organization, for example, cases under the Federal Food, Drug and Cosmetics Act.

Modern corporations typically decentralize authority. Management at

headquarters lays down the general policy and charges employees in local areas with the responsibility of conducting the business.

New policies and new approaches to problems are worked out by management in headquarters. In the usual case, however, criminal violation does not occur at this level. Instead, criminal violation grows out of activities at the local level — activities which are often contrary to company policy.

Against this background, it seems to me that a number of factors must be considered in devising an appropriate sentence in a corporate setting. These include, among others, the guilt or innocence of the particular individuals who are charged with criminal misconduct, the nature of the offense itself, the likelihood of civil litigation being brought against the corporation and an evaluation of what effect the proposed sanctions will have in preventing future violations. The economic model could be very helpful in many instances but I do not believe it should be a substitute for thoughtful individual judgment in a specific case.

Given the complexity of a business organization and the number of factors that could have a bearing on sentencing, I am not at all sure that the proposal of relying almost exclusively on monetary considerations for deterrence makes good sense. The deterrent affect of a fine is diffused in the corporate setting, since the responsible party, the agent or negligent management will not bear the cost of the fine, the stockholders will and in almost all cases without any knowledge or role in the criminal conduct.

The cause of the culpable conduct may not have been a cold profit and loss calculation of the criminal risks involved. There may have been a breakdown

in communications, a failure to understand the implications of particular conduct or the failure of a few individuals to appreciate fully the policies and beliefs of the corporate organization as a whole. This suggests that education and compliance programs within the corporation may have been deficient — not that everyone in the corporate structure was guilty of criminal misconduct.

Let me turn now to some very specific problems with the approach that has been proposed: As I understand it, not only actual harm but potential harm can be used to calculate the base number to which the multiplier applies. The potential harm that can occur from a violation of an environmental regulation or from an illegal agreement to overcharge customers for a basic commodity can be very great.

The potential harm could be in the billions of dollars and not be an appropriate measurement of corporate liability. Assume for a moment a situation similar to Bhopal but without the disastrous results. The malfunction which was a criminal act was discovered in time and while there were some injuries, there was not the widespread devastation. Under these circumstances, would the potential harm if the matter had not been corrected be the proper measure for a fine? Would it have made a difference if the discharge of chemicals, for which the corporation was liable, was done pursuant to an act of sabotage by an employee in violation of company practices and policies or was one of many similar acts reflecting criminal negligence by the company and its management in total disregard of public safety and good operating practices?

If actual harm has occurred, it seems to me that civil sanctions should be the primary monetary sanction with suits instituted by the parties who have been hurt. This enables the money to flow directly to the parties who have been injured.

The discussion materials mention that the likelihood of civil litigation can be considered as a mitigating factor. The impression I have, however, is that very sizeable fines could be imposed under the Guidelines even though the likelihood of civil litigation was very great. This means, for example, that in antitrust litigation a defendant could be subject to six-fold damages: treble damages in the civil litigation and a comparable amount imposed as a fine. Quite frankly, I do not think that such a punitive result would be sound.

The coordination is essential, I believe, particularly in light of the problems and potentially enormous financial exposure joint and several liability creates affecting the potential and liability of the corporation. These problems were the subject of extensive hearings involving antitrust damages in the Ninety-seventh Congress. See, for example, Hearings before the Subcommittee on Monopolies and Commercial Law of the Committee on the Judiciary, House of Representatives, 97th Congress, First and Second Sessions on Antitrust Damage Allocation, October 21, 1981, March 3, 18, June 9, and September 9, 1982. This problem is also present in other cases such as environmental.

I mention an antitrust violation although the Discussion Materials exclude coverage of antitrust offenses by organizations. However, comments were solicited whether guidelines for such offenses should be integrated into the proposed new Chapter 8. I believe they should be, but they do point out the

problem that arises when the criminal activity in question is not intentional or done with the mens rea that is usually found in most criminal offenses. They also support the need to coordinate the criminal sanction and the civil liability because of the powerful treble damage civil remedy. At this point I should note that I am in complete agreement with the third basic principal of organizational sentencing, that the several criminal sanctions and civil remedies available for the same organization offense should be coordinated to produce the appropriate total sanction in the most effective manner.

There are also the "what if" cases where nothing has actually happened. In this type of situation, I doubt whether the potential for harm is the right measure. It seems to me that something less would be appropriate and that considerations such as whether the corporation discovered the problem itself or whether some third party discovered the problem should have a bearing on the sentence to be imposed.

The use of a multiplier is something else which concerns me. As indicated earlier, the multiplier selected is to be much greater if the crime cannot easily be detected. This approach ignores factors such as how seriously society views the crime and the degree of moral culpability. It is quite possible, for example, that low detectability merely reflects the fact that society does not regard the enforcement of the particular statute to be of great significance. In such a case, it would not make sense to employ a larger multiplier. Indeed, speeding on a deserted highway would appear, under the guidelines, to be a more reprehensible act than speeding in a crowded city.

A more serious problem arises where the corporation is given a higher

multiplier because lower level employees sought to conceal the commission of the offense. In the situation where the corporation is held responsible solely because of vicarious liability, it seems highly inappropriate and perverse to further punish innocent parties, such as stockholders and indirectly other employees, where the responsible employees tried to conceal their illegal actions in order to prevent or avoid disciplinary action by the corporation because their acts were in violation of corporate policy. Surely this situation should be distinguished from that where the actors were acting pursuant to corporate practice and with the approval of management.

Based upon my experience, the most effective penalties are those which are directed at the morally culpable individuals, not the corporation.

In any event, determining the amount of the multiplier would call for the making of a very subjective judgment. I submit that no one can tell you with any degree of certainty how likely something is to be detected. Given the fact that a subjective judgment is going to be made anyway, I would rather see that judgment exercised in a broad evaluation of more fundamental factors: the nature of the offense, including the clarity of the law or regulations involved, the degree to which the conduct was willful and in disregard of the interests of others in the community, the identity of the actor and position within the organization, were the acts pursuant to or in violation of corporate policy, the nature and extent of the organization's internal compliance and audit programs, the degree to which further education is needed within the corporation, the extent to which civil damages will compensate those injured, the impact of the sanction upon innocent parties and the many other factors which would suggest themselves to the sentencing judge. This Commission

in its April 13, 1987 guidelines (p. 1.7) commented upon the "difficulty of foreseeing and capturing a single set of guidelines that encompasses the vast range of human conduct potentially relevant to a sentencing decision." I agree and for that reason would urge the economic model proposed be used more as a policy statement than as guidelines.

It is also possible that the application of the proposed formula could result in a monetary penalty beyond the capacity of the corporation to pay. Under the guidelines, if the potential for harm is great and the likelihood of detection is low, a penalty in the billions of dollars could result. The Working Paper in support of the Guidelines comments (p. 60):

"* * * Unless there is some reason — which I have not found — why non-monetary penalties are better able to extract the full monetary equivalent, it seems to me that forced liquidation (or reorganization) is the appropriate solution. At least then the assets will go to the highest bidder, and society will have minimized its losses, which seems preferable to allowing the continued operation of an organization that by definition is a net social burden, having created more loss than it can recompense* * *."

Even though a forced sale of the assets would occur only in rare cases, this possibility raises serious questions about the validity of using the formula. The resulting harm to stockholders and innocent employees is ignored. To arrive at such a result based upon rigid adherence to a questioned mathematical formula suggests a callousness that I am sure the Commission did not intend. I have difficulty in understanding why a district judge should follow the formula in such a case when other alternatives may be available. It seems to me that we would be better off allowing the trial judge to exercise his discretion in this type of situation. Perhaps some time of community service as an in-kind substitute for monetary sanctions should be considered as a less punitive sanction in this situation.

I am well aware that one of the purposes of the Guidelines is to help develop a consistency of approach in sentencing corporations. This is a laudable goal — one we should try to achieve. I question, nonetheless, whether adopting a formula is the right approach.

I think it is also important to keep in mind that we in the United States have criminalized more activity with which we disagree than any other society. This is particularly so in the field of regulation, almost all regulatory legislation has some criminal penalty involved presumably in order to give as many enforcement alternatives as possible. We need to look at the laws of other industrialized nations, to the extent we have over utilized the criminal sanction we should be careful in what sentences we impose under these circumstances.

Let me say in this connection that serving on the federal bench is, among other things, a humbling experience. I found that on many occasions my preconceptions about a particular ruling, or about a case that I was trying, had to be modified or changed entirely as the matter progressed. This experience leads me to believe that no formula — no matter how carefully devised — will fit all the cases. Many situations, particularly in sentencing, tend to be unique. As the draft materials indicate, we have had far less experience in sentencing organizations as compared to individuals. For this reason alone, I would think we would be better advised to use these materials as policy statements rather than as guidelines to be applied in all situations regardless of circumstances.

The genius of the American legal system, particularly as expressed in

the Constitution, is that we have developed general concepts that have allowed the courts to craft just solutions in response to changing circumstances. These concepts are familiar to all of us: the "establishment of religion", "unreasonable searches and seizures", "due process of law" and "just compensation" to mention only a few of them. Over the generations, these concepts have provided the necessary flexibility so that sound results can be reached in a variety of different circumstances. In my view, flexibility in sentencing is just as important as flexibility in reaching sound results on the merits. The history of the law has not been logic, it has been experience. We need to get experience under these materials as policy statements before they can be used as guidelines.

Let me turn to another subject. The Guidelines contemplate the use in certain circumstances of non-monetary sanctions like probation (S.8D2.1). I agree with the limited use contemplated of this sanction. The staff working paper correctly points out the preference for monetary penalties over the alternative of direct intervention into business activities through organization probation, and points out the problems which would be presented by such intervention (pp. 47-50). The alternative Draft Proposal which recommends a greater use of organizational probation may create greater problems than it seeks to solve. I have no question with the concept that the purpose of the Guidelines "is to improve the corporation's own monitoring controls and to increase the probability that internal warning systems will detect future criminal behavior" (p.7). There is ample authority supporting such a limited goal of probation, i.e., under Securities Act regulations and the Foreign Corrupt Practices Act of 1977. I would encourage the development of corporate educational and compliance programs, with their attendant internal monitoring and auditing controls. However, where the criminal act is outside of the normal

course of business, such as an act prohibited by the law, even greater emphasis should be placed on the educational program. I believe that probation can be used in appropriate cases, but it should be used sparingly.

Let me try to point out some of the problems which may arise from expanded use of judicially appointed overseers to supervise the affairs of a corporation.

The standards for organizational probation, included in the discussion materials, envisage cases where a corporation convicted of criminal misconduct will be supervised to a considerable degree.

Under the "standard" terms of probation, an organization would be required, first of all, to answer "all requests for information, financial data or reports on business operations." The answers must be verified under oath. The only defenses are the individual privilege against self-incrimination, the attorney-client privilege, or "information that the court finds not to be related to any probation condition or sentencing purpose." I submit that almost any request for information, in the hands of a skillful lawyer, could be found related to a "sentencing purpose."

In addition, special probation officers are to be appointed. One may not be enough. The study materials state: "Indeed, in order to assemble the proper expertise to properly monitor organizational compliance with probation terms, it may be necessary to appoint a panel of probation officers for a single probationer" (emphasis added). It seems evident that the panel of probation officers will have considerable power. The study materials also make clear

that such power is to be backed up by the court's authority to issue contempt citations.

Consider an example: Let us suppose that the marketing arm of a Fortune 500 company engages in price fixing. Let us suppose further that the offense was committed by lower level management by agreement with competitors selling similar products. Supervision of lower level management is deemed inadequate, and the circumstances surrounding the offense have not been "adequately clarified" in the criminal proceedings. As a result, probation is ordered and "a panel of probation officers" descends on the corporation to prevent the "risk of recidivism."

How are the probation officers to proceed? Are they to sit in on meetings around the country in which the marketers decide how to price the company's products? Will the probation officers ask for data which support pricing decisions or which compare the prices of the corporation's products with those of others? If the probation officers feel that conduct is questionable, will they direct changes or will they simply make adverse comments in their reports so that the term of probation may be extended or new terms of probation issued?

It is hard for me to see what limits there would be on requests for information or on the authority exercised, directly or indirectly, by the probation officers. Almost anything that a marketing organization does can be related to its pricing policies and practices. And, it is important to understand that whether there has been a violation of the antitrust laws is often difficult to determine even after review by experienced counsel.

Traditionally, criminal antitrust enforcement only occurs with respect to per se violations. In the Northern Pacific case, per se violations were generally described by the Supreme Court as follows: These are "certain agreements or practices which because of their pernicious effect on competition and lack of any redeeming virtue are conclusively presumed to be unreasonable." It followed, according to the Court, that such practices are illegal "without elaborate inquiry as to the precise harm they have caused or the business excuse for their use."

Given such a broad formulation, it is not surprising that the courts have had some difficulty in defining which offenses are per se (and, therefore, subject to criminal prosecution) and which are not. Let me illustrate: In U.S. v. Arnold, Schwinn & Co., certain customer restrictions were held to be per se violations. The very same court, however, had held that such restrictions were lawful in U.S. v. White Motor. Subsequently, the Schwinn case itself was overruled in Continental TV v. GTE Sylvania.

What is true in the antitrust field also applies to environmental regulations. Often, these regulations are extremely technical and impose strict liability even though it is sometimes difficult to determine whether conduct is lawful or unlawful.

It seems unrealistic to me that a panel of probation officers are the ones who should evaluate the activities of a corporation and determine, as a judge and jury would, whether certain corporate activities are within or without the law.



I would like to conclude by offering some very general ideas about the approach that I think the Sentencing Commission should consider. My views are tempered by the uncertainties that exist in understanding why we punish and in predicting the effects that enforcement may have:

- o There should be no reliance on just one form of sentencing to the virtual exclusion of others. A sizeable fine may be appropriate in one case. A limited form of probation may be the best solution in another.
- o The trial judge, if the circumstances warrant, should have the discretion to use two or more forms of sentencing concurrently.
- o Devising a mandatory formula for determining the amount of the fine to be imposed is probably a mistake. Formulas have a way of breaking down when applied to the almost endless array of factual situations that come before the courts.
- o No one questions but that the work of the Commission and other organizations represent a valuable contribution to our knowledge in this field. Given the inherent uncertainties involved, I believe the Commission should direct its efforts to developing general formulations or concepts about sentencing. The application of these ideas should be left to the trial judge.
- o If a more specific guideline is deemed necessary, such as a formula for determining the amount of a fine, the guideline should be put



forward as a policy statement rather than as a mandatory requirement for the trial judge to follow. We need more data and much more experience before definitive guidelines can be reached and made compulsory in all cases.

I end with a plea that this Commission not take away all of the discretion from the sentencing judge. To do so would be, I believe, a mistake. Let me give you an example. While it is not relevant to the precise issues being heard here today, it does point out the need for as much flexibility as possible. Under the Guidelines presently in effect, probation is not available in draft evasion cases. The minimum sentence requires 10 months incarceration and that, in all likelihood, would be increased when persons are being inducted during time of war or armed conflict. When I first became a judge there were a large number of such cases, particularly in our district, and they were most difficult. While prison may have been appropriate in a number of these cases, there were some where I felt that prison would have destroyed a number of very ignorant and naive young men. Unless you have visited prisons you can have no idea what happens to such young men when they enter prison. When this human destruction is viewed against the backdrop of wiser young men extending their education to avoid the draft or joining the National Guard as present political leaders in both parties did or learning the simple litanies that brought conscientious objector status, you create a situation where a judge should be free to fashion a more flexible and appropriate sentence. The use of probation in such cases, conditional upon two years of community service doubtless saved lives that otherwise would have been destroyed.

estimated to cost the affected population more than all of the robberies committed against individuals that year. Shareholders in particular bear the costs on both sides. As taxpayers, they pay the costs of the prosecution; as shareholders they pay the costs of the defense. The highest level of corporate management, however, pays very little. They almost never go to jail; in fact, they very seldom lose their jobs. The company pays the fines, which are seldom calculated to offset any gains, and the company pays the officer's legal fees. The business judgement rule and limitation on directors' liability restrict shareholders' ability to get the courts to order reimbursement for the payment of these expenses or the loss in share value.

From the point of view of the shareholder, particularly the large institutional investor, there no issue more important than establishing their capacity to require that corporations they invest in comply with the standards of criminal behavior established by society. Pension funds, in particular, who are the epitome of the long term investor, are held in trust for millions of working Americans who want to retire in a country that is, among other things, law abiding. It is clearly in their interests as shareholders and as citizens to make sure that the companies they invest in abide by the law.

Although there is great public concern over the existence and extent of corporate crime, there is remarkably little baseline scholarship--virtually no centralized sources of information, no agreement on terminology, and only the slightest sense that we are even now grasping the extent of the problem. The "scholarship" boils down to two studies--Sutherland's White Collar Crime, published in 1949, and the various collaborative works of Marshall Clinard and Peter Yeager, sponsored by the U.S. Department of Justice, including Illegal Corporate Behavior and Corporate Crime (1980). Illegal Corporate Behavior confirmed Sutherland's principal finding: corporations violate the law with great frequency. The 582 Corporations surveyed by Clinard and Yeager racked up a total of 1,554 crimes, with at least one sanction imposed against 371 corporations (63.7%) of the sample. And although 40% of the sample had no actions initiated against them, a mere 38 parent manufacturing corporations out of a total of 477--less than 10 percent--had ten or more actions instituted against them. These 38 recidivist corporations accounted for 740, or 48.2%, of all sanctions imposed against all parent manufacturing firms surveyed."³ In 1980, Fortune magazine surveyed 1,043 large companies and concluded that a "surprising" and "startling" number of them had been involved in "blatant illegalities". "Almost two years after the Fortune story, U.S.

³Mokhiber, Russell, Corporate Crime and Violence, Big Business and the Abuse of the Public Trust, (Sierra Club, 1988), pp. 18 and 19.

News & World Report conducted a survey of America's 500 largest corporations and found that '115 have been convicted in the last decade of at least one major crime or have paid civil penalties for serious misbehavior.'" (U.S. News defined "serious misbehavior" as criminal convictions or civil penalties or settlements in excess of \$50,000)."⁴ Recent concern over the extent of criminal activity in dealings with the Defense Department has been so pronounced as to require no further comment here.

There is a curious numbness and sense of resignation with the problems presented by corporate criminal activity. While no one condones it, no one seems to know what to do about it. There is almost an acceptance that corporate criminality may be part of the inevitable price for the undoubted benefits derived from large business organizations.

Pentagon and Justice Department officials have been eager to show they are cracking down on procurement fraud, especially in light of lengthy delays in a separate, much-publicized nationwide inquiry into bribery and influence-peddling involving contractors and prominent defense consultants. For example, just two days ago, Bruce Kovens, head of the Pentagon's criminal investigative office in Philadelphia, said that General Electric was included in the indictment of its subsidiary because the evidence showed that GE "was responsible for the wrong-doing" in its subsidiary. Kovens said the charges against the parent company show that Defense Department officials "are determined to conscientiously investigate and prosecute all offenders, not just small companies."

But, the applicability of criminal law constraints to corporations has been mired in apparent effort to treat artificial entities as if they were natural persons. "Did you ever expect a corporation to have a conscience, when it has no soul to be damned, and no body to be kicked?"⁵ Concludes one of the most astute current observers, "At first glance, the problem of corporate punishment seems perversely insoluble: moderate fines do not deter, while severe penalties flow through the corporate shell and fall on the relatively blameless."⁶

⁴Ibid.

⁵Edward, First Baron Thurlow 1731-1806, quoted in M. King, Public Policy and the Corporation (1977).

⁶Coffee, John C., Jr., "No Soul to Damn: No Body to Kick: An Unscandalized Inquiry into the Problem of Corporate Punishment," Michigan Law Review, Vol. 79, pp. 386 and 387, (1981) [Hereinafter--Coffee: Corporate Punishment].

Although many ingenious solutions have been suggested, including the "equity fine" (Coffee: Corporate Punishment, 413-424), one is ultimately forced to confront the reality"...that companies have two kinds of records: those designed to allocate guilt (for internal purposes), and those for obscuring guilt (for presentation to the outside world). When companies want clearly defined accountability, they can generally get it. That is what management theory is all about. Diffused accountability is not always inherent in organizational complexity; it is in considerable measure the result of a desire to protect individuals within the organization by presenting a confused picture to the outside world. One might say that courts should be able to pierce this conspiracy of confusion. Without sympathetic witnesses from within the corporation who are willing to help, this is difficult."⁷

Despite some efforts to place corporations "on probation," to require payments to societally useful causes, even to jail executives, it is plain that nothing presently being done is acceptably effective and that the problem is becoming more acute. One must simply raise the question as to whether society can indefinitely countenance a situation in which corporate crime is endemic.

Surely those with the largest interest in making societal and corporate interests compatible are the long-term owners. Unless they are able to develop a "cost effective" approach to the problems caused by corporate criminality on an ad hoc basis, some significant regulatory effort should be contemplated. There will always remain need for legal sanctions: "[S]ome executives abstain from bribery because they are afraid of being punished. Most abstain from bribery because they view it as immoral. One reason that they view it as immoral is that executives who bribe are sometimes punished and held to public scorn. Do away with criminal punishment and you do away with much of the sense of morality which makes self-regulation possible. Self-regulation and punitive regulation are, therefore, complementary rather than alternatives."⁸ And yet, "[T]he firm is better positioned than the state to detect misconduct by its employees. It has an existing monitoring system already focused on them, and it need not conform its use of sanctions to due process standards. Indeed, if the penalties are severe enough, the corporation has both the incentive and, typically, the legal right to dismiss any employee it even suspects of illegal conduct."⁹

⁷Braithwaite, John, Corporate Crime in the Pharmaceutical Industry, Routledge & Keegan Paul, 1984, p. 324.

⁸Ibid., p. 319.

⁹ Coffee: Corporate Punishment, p. 408.

Let's pause to consider the position of institutional shareholders. They have no interest in or competency to develop or proscribe internal corporate procedures. No matter how large their investment, the return cannot be large enough to justify any kind of meaningful involvement in day-to-day operation of the company. In any event, it is not appropriate for the shareholders to concern themselves with how a corporation devises information flows to assure that notice is received at the appropriate level of conduct likely to be deleterious to society, how a company develops incentive systems to assure that compliance with law has the clear and undivided attention of appropriate personnel, or what review structures are established to monitor, review, document and validate compliance with law are not the appropriate concern of the shareholder. Their concern is to hold managements accountable for their conduct of the business "within the rules," and to thus create an incentive for management to establish a structure ensuring that compliance with the law receives the highest priority. It is noteworthy that Professor Friedman's well known aphorism that management's sole obligation is to maximize the value of the firm is importantly conditioned that such be "within the rules." To put it simply, shareholders hire managers to run their business in a way that will encourage a supportive governmental and societal climate to capitalist enterprise.¹⁰ Increasing corporate criminal activity is hostile to an attitude of public support in the future. Conceivably, management has been so caught up in the pursuit of short term profit (institutional shareholders have their share of blame in this regard) that it has failed to grasp the utter unacceptability of a situation in which corporate criminal activity not only is rampant but apparently is beyond the power of any to abate. Shareholders need to make unmistakably clear to those they hire that continued corporate crime will not be tolerated.

Setting forth the conditions of eligibility for service on the Board of Directors appears uniquely appropriate for shareholder concern and by-law implementation. One of the most important mechanisms available to shareholders is the power to elect directors. Certainly, the power to elect directors includes the power to establish eligibility, and certainly, commitment to compliance with the criminal law is a legitimate criterion. The fact that slates of directors, in virtually all cases, are nominated by management and run without opposition makes establishment of eligibility criteria especially

¹⁰ "Through the generally more active participation of their shareholders, cooperatives also offer the consumer greater control over management decisions than is provided to shareholders in large corporations." Clinard, Marshall, Illegal Corporate Behavior and Corporate Crime (1980), at p. 325.

appropriate. The Board of Directors has the authority, indeed the responsibility, to promulgate basic corporate policies. Yet the trend these days is to limit their liability, removing them even further from accountability. "More active stockholder participation might force greater corporate compliance with the law in some areas, although, as we have pointed out, their primary concern is often corporate stock growth and dividends...Far reaching corporate reform, however, depends on altering the process and structure of corporate decisionmaking. Traditional legal strategies generally do not affect the internal institutional structure...At present few clear functions are usually specified for corporate boards of directors; they frequently have served as rubber stamps for management. If a functional relationship and responsibility to actual corporate operations were established, directors would be responsible not only for the corporate financial position and stockholder dividends but also for the public interest, which would include the prevention of illegal and unethical activities undertaken in order to increase profits."¹¹

Institutional Shareholder Services represents owners who are trying to find a way to act effectively to assure that "their" companies comport with society's determination of acceptable behavior. In that connection, we wrote the attached letter to our clients, enclosing the letters we sent to a number of corporations (also attached).

The thrust of the proposed by-law amendment is that directors are highly motivated to continue to be eligible to serve as directors of public companies; that they have the authority to establish policies requiring management to implement obedience to the law as a corporate priority; and that placing responsibility on directors assures that "the buck will stop somewhere". Consideration of the many ways that management might implement its mandate is beyond the scope of this paper; suffice it simply that many corporations have such in place at the present time and substantial learning and experience are available.¹²

¹¹ Clinard, Marshall op cit supra at p. 307

¹²Consider for example the following excerpts from "Taming the Giant Corporation," by Ralph Nader, Mark Green, and Joel Seligman, printed in Donaldson, Thomas and Werhane, Patricia H., Ethical issues in Business - A Philosophical Approach (Prentice Hall, 1988), pp. 429 and 430: "[T]he board should designate executives responsible for compliance with these laws and require periodic signed reports describing the effectiveness of compliance procedures. Mechanisms to administer spot checks on compliance with the principal statutes should be created.

Professor Christopher Stone's Where the Law Ends¹³ is perhaps the best known work on this general subject. He concludes that the suspension of directors is the most effective way of dealing with the problems of corporate criminality. "In general, though, I think it would be best if for all but the most serious violations we moved in the opposite direction, relaxing directors' liability by providing that any director adjudged to have committed gross negligence, or to have committed non-feasance [This translates to the enactment of policies to carry out our proposed new by-law] shall be prohibited for a period of three years from serving as officer, director or consultant of any corporation doing interstate business. Why is this better than what we have now? For one thing, the magnitude of the potential liability today has become so draconian that when we try to make the law tougher on directors the more likely effects are that corporate lawyers will develop ways to get around it, judges and juries will be disinclined to find liability, and many of the better qualified directors will refuse to get involved and serve. The advantages of the "suspension" provision, by contrast, are that it is not so easy to get around; it is not so severe that, like potential multi-million-dollar personal liability, it would strike courts as unthinkable to impose; but at the same time it would still have some effective bite in it -- the suspendees would be removed from the most prestigious and cushy positions ordinarily available to men of their rank, and would, I suspect, be object of some shame among their peers."

The limitations of the government in preventing and punishing corporate crime are all too plain. Neither the requirements nor the sanctions established by our laws reach those who make the decisions to engage in criminal activity, at least not forcefully enough to dissuade them. I believe that the object of sentencing guidelines in this area should be to promote internal mechanisms for accountability. That can best be accomplished in two ways. First, there should be a presumption that any criminal activity whose benefits are primarily reaped by the corporation (as opposed to criminal activity benefiting the individual, at the expense of the corporation, like embezzlement) is conducted with the consent of the corporation, and the highest level of the company should be held liable. Second, the structures in place for self-regulation at the corporation, should be a major factor in determining the appropriate sanctions. If, for example, the company has in place a by-law

Similar mechanisms can insure that corporate "whistle blowers" and nonemployee sources may communicate to the board - in private and without fear of retaliation - knowledge of violations of law."

¹³Stone, Christopher D., Where the Law Ends, The Social Control of Corporate Behavior, (Harper & Row, 1975) p. 148.

making individuals who permit the company to engage in criminal activity ineligible for director positions, a strong program for employee education and monitoring, and its own internal sanctions for either violating the law or allowing it to be violated, that would help to establish that any criminal activity was not attributable to the corporation itself and its directors. It is, in a way, a method for determining the corporate "mens rea," and as such is entirely appropriate to examine in determining sanctions.

November 7, 1988
Mr. Derek C. Bok
President
Harvard University
Massachusetts Hall
Cambridge, MA 02138

Dear Derek:

We have heard from many of our clients increasing concerns about corporate criminal behavior, and its impact on share value. The decision to violate the law occurs when, at some level, management finds that the benefits outweigh the costs. Or, more likely, management finds that the benefits accrue to the corporation, while the costs are borne elsewhere. The threat of criminal enforcement proceedings does not provide adequate incentives to obey the law, and we believe that shareholders can play a constructive and important role in creating appropriate incentives.

Employees, suppliers, non-government customers, all feel the impact when corporate resources are redirected from productivity and competitiveness to litigation defense. Shareholders in particular bear the costs on both sides. As taxpayers, they pay the costs of the prosecution; as shareholders they pay the costs of the defense. The highest level of corporate management, however, pays very little. They almost never go to jail; indeed, they very seldom lose their jobs. The company pays the fines, which are seldom calculated to offset any gains, and the company pays the officers' legal fees. The business judgment rule and limitation on directors' liability restrict shareholders' ability to get the courts to order reimbursement for the payment of these expenses or the loss in share value.

Even more disturbing than a criminal conviction is when management implicitly endorses the criminal activity afterward. For example, Morton M. Lapedes was permitted to take Alleco private after he was convicted of a price-fixing scheme that resulted in record-breaking fines. Mr. Lapedes is currently being investigated by a federal grand jury, the Securities and Exchange Commission and the IRS. He is being sued by shareholders to block his takeover of Alleco. Even if he did have the integrity and leadership to manage Alleco during this critical period, he just doesn't have the time.

Another example is Beech-Nut's violation of the food and drug laws. The president and vice president of Beech-Nut admitted that they knowingly permitted adulterated apple

juice to be sold in markets to be consumed by babies. The company pled guilty to 215 counts of federal food and drug violations, and paid a \$2 million fine. This has severely damaged its credibility. Even worse, its market share has dropped 15 percent as a result. This is a clear example of shareholder losses directly attributable to criminal conduct. It is reasonable for the shareholders to expect the directors to make sure that this kind of thing does not happen again.

Did the directors fire these men? On the contrary. They paid all of their legal fees, and they continue to pay their salaries, and have committed to do so until their appeals run out.

Shareholders can reasonably conclude that in doing so the directors have made it clear to the company's employees, its customers, and the community that it will tolerate, even support, the knowing sale of colored sugar water as apple juice, to be fed to babies. They have made it clear that they will tolerate, even support, actions that result in record-breaking criminal penalties. Shareholders can and should reasonably conclude that the directors have made it clear that they do not deserve the shareholders' support. And they should not give it.

We believe that management can send a strong signal to its employees and the community by insisting that its directors be responsible for preventing criminal behavior. A first step would be by adopting a policy or a by-law on the subject. We believe it should make ineligible for a position on the board anyone convicted of a felony in connection with his service on the board, or anyone who served on the board while the company was engaging in behavior leading to a criminal conviction. This would apply only if the crime was related to the central business activities of the corporation. We have identified two groups of companies as candidates for such a step; one group whose tradition of commitment to integrity and shareholder concerns indicates that they might be willing to be leaders in this area. The other group consists of companies whose record of criminal investigations makes them good candidates for an expression of shareholder concern.

We have written to both groups, enclosing suggested language for by-laws or policy statements. I am enclosing a list of the companies we wrote to, and samples of the language we suggested for the companies, depending on their line of business.

It is important to emphasize here that some infractions are inevitable. Laws and regulations are complex, and their

interpretation and enforcement vary enormously from one administration to another. Shareholders do not want companies to be so risk-averse that they always adopt the most conservative interpretation possible; sometimes it is worthwhile to challenge the law. And Congress has a tendency to react to a problem by making it criminal; Congress tries to appear to be cracking down on defense contractors and polluters, and does so by characterizing relatively minor violations as criminal. But directors must take the responsibility for setting some standards for the company.

Shareholders can protect and enhance the value of their holdings by making sure that corporate directors will not permit corporate crime. They do not have to sell out in disgust, or foot the additional bill for litigation. They can take the opportunity provided to them by the SEC to become informed about a company's risk of prosecution and use their proxies to make sure that the company has directors who will minimize that risk.

We urge you to read through the enclosed letters and the suggested by-laws. You may want to write to these companies yourself to endorse their adoption of such a by-law, or to send similar letters to other companies. If so, I hope you will send us copies. If the corporations who receive these letters are not responsive to these concerns, you might want to consider a shareholder resolution proposing the adoption of such a by-law yourself. I am enclosing a list of the deadlines for shareholder resolutions at these companies to assist you in doing so. We would be happy to help you to draft the resolutions, or to obtain support from other institutional shareholders.

Shareholders are affected by corporate criminal activity, and can take cost-effective action to demonstrate their concern and enhance value. I welcome your comments and suggestions on our proposals.

Sincerely,

Robert A. G. Monks

Encls.

LETTER A

October 26, 1988

Mr. Warren H. Phillips
Chairman of the Board
Dow Jones & Company, Inc.
200 Liberty Street
New York, NY 10281

Dear Mr. Phillips:

Institutional Shareholder Services, Inc. is a consulting firm that advises large institutional shareholders on corporate governance issues. Our clients are long-term investors with a substantial equity position in your company. They believe that exercise of the rights of ownership can protect and enhance the value of their investments, and that as fiduciaries for the beneficial owners of the stock, they must do so when it is economically justified.

Our clients are increasingly concerned about corporate crime, not just as a matter of public policy, but as a matter of investment policy. Companies that break the law incur huge legal fees and fines. They must devote enormous resources to preparing their defense. They lose goodwill in the community, and they lose business.

We have been impressed with your company's exemplary record, both in corporate governance and in making a commitment to the highest standards of ethical behavior. Our clients have demonstrated their support by buying and holding your stock. The latest figures we have show that institutions hold more than ^{^F8^}% of your shares. We would like you to go one step further in establishing your commitment to shareholder concerns and compliance with the laws by proposing the adoption of a by-law along the lines of the enclosed.

The by-law provides that any director who is convicted of a felony in connection with his or her service as a director will become ineligible for service on the Board. Similarly, any director serving at a time when the corporation is criminally convicted will also become ineligible for continued service (unless he or she voted against the conduct leading to the criminal conviction).

This by-law is intended to reach only the most extraordinary violations. It would not be triggered by criminal charges against corporate officers or employees (unless they also serve as directors). Some infractions are inevitable. Laws and regulations are complex, and their interpretation and enforcement vary enormously from one administration to another. Shareholders do not want companies to be so risk-averse that they always adopt the most conservative interpretation possible; sometimes it is worthwhile to challenge the law. And Congress has a tendency to react to a problem by making it criminal; Congress tries to appear to be cracking down on defense contractors and polluters, and does so by characterizing relatively minor violations as criminal. But directors must take the responsibility for setting some standards for the company.

The most important right granted to shareholders in exchange for their funds is the right to elect directors. That right carries with it the right to establish criteria for eligibility. The shareholders we work with would like to see you initiate action to adopt a policy or by-law along the lines of the enclosed draft to make it clear that you have a strong commitment to complying with the law, and a commitment to being responsive to shareholder concerns. We believe it would enhance your standing in the community and the value of their investment. We cannot see any possible case in which your company would want to retain a director covered by this by-law; adoption would simply make the removal automatic.

We would appreciate the opportunity to discuss this proposal with you. We are interested in your reaction, and we look forward to hearing from you.

Sincerely,

Robert A. G. Monks
President

Enclosure

**LIST OF ADDRESSEES FOR "LETTER A" CONCERNING PROPOSED
CORPORATE CRIMINAL ACTIVITY BY-LAW**

Mr. Warren H. Phillips
Chairman of the Board
Dow Jones & Company, Inc.
200 Liberty Street
New York, NY 10281

Mr. Colby H. Chandler
Chief Executive Officer
Eastman Kodak Company
343 State Street
Rochester, NY 14650

Mr. John F. Welch, Jr.
Chairman of the Board
General Electric Company
3135 Easton Turnpike
Fairfield, CT 06413

Mr. Norman R. Augustine
Chairman and Chief Executive Officer
Martin Marietta Corporation
6801 Rockledge Drive
Bethesda, MD 20817

Mr. James R. Stover
President and Chief Executive Officer
Eaton Corporation
1111 Superior Avenue
Cleveland, OH 44114

Mr. Frank A. Shrontz
Chairman and Chief Executive Officer
The Boeing Company
P.O. Box 3707
Seattle, WA 98124

Dr. Ruben F. Mettler
Chief Executive Officer
TRW Inc.
1900 Richmond Road
Cleveland, OH 44124

Mr. Frank P. Popoff
President and Chief Executive Officer
The Dow Chemical Company
2030 Willard H. Dow Center
Midland, MI 48674

Mr. George M.C. Fisher
President and Chief Executive Officer
Motorola, Inc.
1303 East Algonquin Road
Schaumburg, IL 60196

Mr. Bernard Schwartz
Chairman and Chief Executive Officer
Loral Corporation
600 Third Avenue
New York, NY 10016

LETTER B

October 26, 1988

Mr. Lawrence G. Rawl
Chairman and Chief Executive Officer
Exxon Corporation
1251 Avenue of the Americas
New York, NY 10020-1198

Dear Mr. Rawl:

Institutional Shareholder Services, Inc. is a consulting firm that advises large institutional shareholders on corporate governance issues. Our clients are long-term investors. They believe that exercise of the rights of ownership can protect and enhance the value of their investments, and that as fiduciaries for the beneficial owners of the stock, they must do so when it is economically justified.

Our clients are increasingly concerned about corporate crime, not just as a matter of public policy, but as a matter of investment policy. Companies that break the law incur huge legal fees and fines. They must devote enormous resources to preparing their defense. They lose goodwill in the community, and they lose business.

Our clients have expressed serious concerns about your commitment to compliance with the law. The latest figures we have show that institutions hold more than 33% of your shares. They are long-term investors; they would prefer not to sell out because of their concerns, especially since they believe that your poor record has depressed the stock. Their alternative, then, is to work with you to improve value. We would like you to establish your commitment to shareholder concerns and compliance with the laws by proposing the adoption of a by-law along the lines of the enclosed.

The by-law provides that any director who is convicted of a felony in connection with his or her service as a director will become ineligible for service on the Board. Similarly, any director serving at a time when the corporation is criminally convicted will also become ineligible for continued service (unless he or she voted

against the conduct leading to the criminal conviction).

This by-law is intended to reach only the most extraordinary violations. It would not be triggered by criminal charges against corporate officers or employees (unless they also serve as directors). Some infractions are inevitable. Laws and regulations are complex, and their interpretation and enforcement vary enormously from one administration to another. Shareholders do not want companies to be so risk-averse that they always adopt the most conservative interpretation possible; sometimes it is worthwhile to challenge the law. And Congress has a tendency to react to a problem by making it criminal; Congress tries to appear to be cracking down on defense contractors and polluters, and does so by characterizing relatively minor violations as criminal. But directors must take the responsibility for setting some standards for the company.

The most important right granted to shareholders in exchange for their funds is the right to elect directors. That right carries with it the right to establish criteria for eligibility. The shareholders we work with would like to see you initiate action to adopt a policy or by-law along the lines of the enclosed draft, to make it clear that you have a strong commitment to complying with the law, and a commitment to being responsive to shareholder concerns. We believe it would enhance your standing in the community and the value of their investment. We cannot see any possible case in which your company would want to retain a director covered by this by-law; adoption would simply make the removal automatic.

We would very much appreciate the opportunity to discuss this proposal with you. We are most interested in your reaction, and we look forward to hearing from you.

Sincerely,

Robert A. G. Monks
President

Enclosure

**LIST OF ADDRESSEES FOR "LETTER B" CONCERNING PROPOSED
CORPORATE CRIMINAL ACTIVITY BY-LAW**

**Mr. Alfred Manville
President and Chief Executive Officer
Fischbach Corporation
485 Lexington Avenue
New York, NY 10017**

**Mr. Lawrence G. Rawl
Chairman and Chief Executive Officer
Exxon Corporation
1251 Avenue of the Americas
New York, NY 10020-1198**

**Mr. Charles S. Locke
Chairman of the Board
Morton Thiokol, Inc.
110 North Wacker Drive
Chicago, IL 60606-1560**

**Mr. Harry J. Phillips, Sr.
Chairman and Chief Executive Officer
Browning-Ferris Industries, Inc.
P.O. Box 3151
Houston, TX 77253**

**Mr. Robert E. Mercer
Chairman of the Board
The Goodyear Tire & Rubber Company
1144 East Market Street
Akron, OH 44316-0001**

**Mr. Richard J. Stegemeier
President and Chief Executive Officer
Unocal Corporation
P.O. Box 7600
Los Angeles, CA 90051**

**Mr. Robert D. Kennedy
Chairman of the Board
Union Carbide Corporation
39 Old Ridgebury Road
Danbury, CT 06817-0001**

Mr. Thomas V. Jones
Chairman and Chief Executive Officer
Northrop Corporation
1840 Century Park East
Los Angeles, CA 90067

Mr. Larry O. Kitchen
Chairman and Chief Executive Officer
Lockheed Corporation
4500 Park Granada Boulevard
Calabasas, CA 91399

Mr. Richard D. Wood
President, Chairman and Chief Executive Officer
Eli Lilly and Company
Corporate Center
Indianapolis, IN 46285

Mr. Thomas D. Sege
Chairman and Chief Executive Officer
Varian Associates, Inc.
611 Hansen Way
Palo Alto, CA 94303

Mr. Paul G. Schloemer
President and Chief Executive Officer
Parker-Hannifin Corporation
17235 Euclid Avenue
Cleveland, OH 44112

Mr. Richard J. Mahoney
Chairman and Chief Executive Officer
Monsanto Company
800 N. Lindbergh Boulevard
St. Louis, MO 63167

Mr. John T. Hartley
Chief Executive Officer
Harris Corporation
1025 W. NASA Boulevard
Melbourne, FL 32919

Mr. Orion L. Hoch

Chairman and Chief Executive Officer
Litton Industries, Inc.
360 North Crescent Drive
Beverly Hills, CA 90210

Mr. J. Peter Grace
Chairman, President and
Chief Executive Officer
W. R. Grace & Co.
Grace Plaza
1114 Avenue of the Americas
New York, NY 10036-7794

Mr. John R. Hall
Chairman and Chief Executive Officer
Ashland Oil, Inc.
1000 Ashland Drive
Russell, KY 41169

Mr. Henry Wendt
Chairman of the Board
SmithKline Bechman Corporation
One Franklin Plaza
P.O. Box 7929
Philadelphia, PA 19101

Mr. Stanley C. Pace
Chairman and Chief Executive Officer
General Dynamics Corporation
Pierre Laclede Center
St. Louis, MO 63105

Mr. Richard E. Heckert
Chairman and Chief Executive Officer
E. I. DuPont de Nemours and Company
D 9000
1007 Market Street
Wilmington, DE 19898

SAMPLE BY-LAW FOR FOOD AND DRUG INDUSTRY VIOLATIONS

RESOLVED, that the by-laws of [] be amended by the adoption of a new Section [], to provide as follows:

"No person who is criminally convicted of a state or federal felony violation for causing death or serious bodily injury to any person by adulterating, misbranding, falsely labeling or falsely advertising a food, drug or device; or who is convicted of a felony violation for obstruction of justice, fraud, corruption of a public official, perjury, or making a false statement in furtherance of or to conceal any such activity; or who is convicted of conspiring to commit or aiding and abetting the commission of any violation described above; whether by trial, guilty plea, or plea of nolo contendere, shall be eligible to serve as a Director or Officer of the corporation for three years from the date of such conviction, unless and until such conviction is overturned or vacated by a court of competent jurisdiction.

If the corporation is criminally convicted of a state or federal felony violation for causing death or serious bodily injury to any person by adulterating, misbranding, falsely labeling or falsely advertising a food, drug or device; or is convicted of obstruction of justice, fraud, corruption of a public official, perjury, or making a false statement in furtherance of or to conceal any such activity; or is convicted of conspiring to commit or aiding and abetting the commission of any violation described above; whether by trial, guilty plea, or plea of nolo contendere, no person who, at the time of the conduct giving rise to the conviction was a Director of the corporation or was the President, Chairman, Chief Executive Officer, or Chief Operating Officer, or was a Vice President, Treasurer or Assistant Treasurer having responsibility for the area of corporate activity where such conduct occurred, and who had held that office for at least one year immediately prior thereto, shall be eligible to serve as a Director or Officer of the corporation for three years from the date of such conviction, unless and until such conviction is overturned or vacated by a court of competent jurisdiction. Provided, that if the corporate conduct giving rise to the conviction was the subject of a vote of the Board of Directors, then this provision shall not apply to any Director who cast his or her vote against such conduct.

Any disqualification effected by this by-law may be

removed by a vote of the holders in beneficial interest of 75% or more of the corporation's shares then outstanding."

SUPPORTING STATEMENT

The purpose of this resolution is to ensure that Directors and Officers are held accountable to shareholders for engaging in or allowing the corporation to engage in criminal conduct that goes to the heart of the corporation's activities. Criminal conduct of this nature, which threatens public health and safety, exposes the corporation to massive criminal fines and civil damage awards, and destroys corporate good will, is never in the best interest of the shareholders or the corporation, and should not be countenanced.

SAMPLE BY-LAW FOR ANTITRUST LAW VIOLATIONS

RESOLVED, that the by-laws of [] be amended by the adoption of a new Section [], to provide as follows:

"No person who is criminally convicted of a state or federal felony violation for price-fixing or other violation of the antitrust laws, or who is convicted of a felony violation for obstruction of justice, fraud, corruption of a public official, perjury, or making a false statement in furtherance of or to conceal any such activity; or who is convicted of conspiring to commit or aiding and abetting the commission of any violation described above; whether by trial, guilty plea, or plea of nolo contendere, shall be eligible to serve as a Director or Officer of the corporation for three years from the date of such conviction, unless and until such conviction is overturned or vacated by a court of competent jurisdiction.

If the corporation is criminally convicted of a state or federal felony violation for price-fixing or other antitrust violation, or is convicted of obstruction of justice, fraud, corruption of a public official, perjury, or making a false statement in furtherance of or to conceal any such activity; or is convicted of conspiring to commit or aiding and abetting the commission of any violation described above; whether by trial, guilty plea, or plea of nolo contendere, no person who, at the time of the conduct giving rise to the conviction was a Director of the corporation or was the President, Chairman, Chief Executive Officer, or Chief Operating Officer, or was a Vice President, Treasurer or Assistant Treasurer having responsibility for the area of corporate activity where such conduct occurred, and who had held that office for at least one year immediately prior thereto, shall be eligible to serve as a Director or Officer of the corporation for three years from the date of such conviction, unless and until such conviction is overturned or vacated by a court of competent jurisdiction. Provided, that if the corporate conduct giving rise to the conviction was the subject of a vote of the Board of Directors, then this provision shall not apply to any Director who cast his or her vote against such conduct.

Any disqualification effected by this by-law may be removed by a vote of the holders in beneficial interest of 75% or more of the corporation's shares then outstanding."

SUPPORTING STATEMENT

The purpose of this resolution is to ensure that Directors and Officers are held accountable to shareholders for

engaging in or allowing the corporation to engage in criminal conduct that goes to the heart of the corporation's activities. Criminal conduct of this nature exposes the corporation to massive criminal fines and civil damage awards, and destroys corporate good will, is never in the best interest of the shareholders or the corporation, and should not be countenanced.

SAMPLE BY-LAWS FOR DEFENSE PROCUREMENT VIOLATIONS

2.17 Qualification of Directors and Officers in the Event of Criminal Convictions.

No person who has been criminally convicted of a state or federal felony for

(a) defrauding the United States Government via one or more instances of cost misallocation, product substitution, failure to perform required tests, defective pricing, bid-rigging, or corruption of a public official,

(b) obstruction of justice, perjury or making a false statement in furtherance of or to conceal any activity described in (a) above,

(c) conspiring to commit or aiding or abetting the commission of any violation described in (a) or (b) above, or

(d) racketeering activity in which any of the violations described in (a), (b), or (c) above or state law bribery is an element,

whether by trial, guilty plea, or plea of nolo contendere, shall be eligible to be elected or to serve as an Officer or Director of the corporation for a period of three years from the date of such conviction, unless and until such conviction is overturned or vacated by a court of competent jurisdiction.

If the corporation is at any time criminally convicted of a state or federal felony violation for

(a) defrauding the United States Government via one or more instances of cost misallocation, product substitution, failure to perform required tests, defective pricing, bid-rigging, or corruption of a public official,

(b) obstruction of justice, perjury or making a false statement in furtherance of or to conceal any activity described in (a) above,

(c) conspiring to commit or aiding or abetting the commission of any violation described in (a) or (b) above, or

(d) racketeering activity in which any of the violations described in (a), (b), or (c) above is an element,

whether by trial, guilty plea, or plea of nolo contendere, no person who, at the time of the conduct giving rise to the conviction, was a Director of the corporation or was the President, Chairman, Chief Executive Officer, or Chief Operating Officer of the corporation, or who was a Vice-President, Treasurer, or Assistant Treasurer having responsibility for the area of corporate activity where such conduct occurred, and who had held such office for at least one year immediately prior thereto, shall be eligible to be elected or to serve as an Officer or Director of the corporation for a period of three years from the date of such conviction, unless and until such conviction is overturned or vacated by a court of competent jurisdiction. Provided, however, that if the corporate conduct giving rise to the conviction was the subject of a vote of the Board of Directors of the corporation, then this provision shall not apply to any Director who cast his or her vote against such conduct.

The felony offenses referred to in this by-law include, without limitation of any kind whatsoever upon the generality of the foregoing, violations of Title 18, United States Code, Section 201 (bribery), Sections 286 and 287 (fraudulent claims), Section 1001 (false statements), Section 1341 (mail fraud), Section 1343 (wire fraud), Section 1503, 1510, 1512 and 1513 (obstruction of justice), Section 1621 (perjury), Section 1952 (travel in aid of racketeering); Section 1962 (R.I.C.O.), Section 371 (conspiracy to defraud the United States), and Section 2 (aiding and abetting), and state law felony offenses involving the same or similar conduct.

A person affected by the operation of this by-law may be rendered eligible to be elected and to serve as a Director or Officer of the corporation prior to the expiration of the three year post-conviction period upon a vote in favor of such eligibility by the holders in beneficial interest of 75% or more of the corporation's shares then outstanding.

SUPPORTING STATEMENT

The purpose of this resolution is to ensure that Directors and Officers are held accountable to shareholders for engaging in or allowing the corporation to engage in criminal conduct that goes to the heart of the corporation's activities. Criminal conduct of this nature exposes the corporation to massive criminal fines and civil damage awards, and destroys corporate good will, is never in the best interest of the shareholders or the corporation, and should not be countenanced.

SAMPLE BY-LAW FOR ENVIRONMENTAL LAW VIOLATIONS

2.17 Qualification of Directors and Officers in the Event of Criminal Convictions.

No person who is criminally convicted of a state or federal felony violation for knowingly or recklessly endangering human health or the environment through the generation, disposal, storage, transportation, treatment or management of a hazardous substance; or who is convicted of a felony violation for obstruction of justice, fraud, corruption of a public official, perjury, or making a false statement in furtherance of or to conceal any such activity; or who is convicted of conspiring to commit or aiding and abetting the commission of any violation described above, whether by trial, guilty plea, or pleas of nolo contendere, shall be eligible to be elected or to serve as a Director or Officer of the corporation for a period of three years from the date of such conviction, unless and until such conviction is overturned or vacated by a court of competent jurisdiction.

If the corporation is at any time criminally convicted of a state or federal felony violation for knowingly or recklessly endangering human health or the environment through the generation, disposal, storage, transportation, treatment or management of a hazardous substance; or is convicted of a felony violation for obstruction of justice, fraud, corruption of a public official, perjury, or making a false statement in furtherance of or to conceal any such activity; or is convicted of conspiring to commit or aiding and abetting the commission of any violation described below, whether by trial, guilty plea, or plea of nolo contendere, no person who, at the time of the corporate conduct giving rise to the conviction, was a Director of the corporation, or was the President, Chairman, Chief Executive Officer, or Chief Operating Officer of the corporation, or was a Vice-President, Treasurer or Assistant Treasurer having responsibility for the area of corporate activity where such conduct occurred, and who had held such position for at least one year immediately prior thereto, shall be eligible to be elected or to serve as a Director or Officer of the corporation for a period of three years from the date of such conviction, unless and until such conviction is overturned or vacated by a court of competent

jurisdiction. Provided, however, that if the corporate conduct giving rise to the conviction was the subject of a vote of the Board of Directors of the corporation, then this provision shall not apply to any Director who cast his or her vote against such conduct.

The felony offenses referred to in this by-law include, without limitation, violations of Title 42, United States Code, Section 6928(d), or (e) (the Solid Waste Disposal Act), Title 49, United States Code, Section 1809(b) (the Hazardous Materials Transportation Act), Title 18, United States Code, Section 201 (bribery), Section 1001 (false statements), Section 1341 (mail fraud), Section 1343 (wire fraud), Sections 1503, 1510, 1512 and 1513 (obstruction of justice), Section 1621 (perjury), Section 371 (conspiracy to defraud the United States), Section 2 (aiding and abetting), and state law felonies involving the same or similar conduct.

A person affected by the operation of this by-law may be re-rendered eligible to be elected and to serve as a Director or Officer of the corporation prior to the expiration of the three year post-conviction period upon a vote in favor of such eligibility by the holders in beneficial interest of 75% or more of the corporation's shares then outstanding.

DEADLINES FOR SHAREHOLDER RESOLUTIONS

Letter A Recipients

Dow Jones & Company, Inc.	November 11, 1988
Eastman Kodak Company	November 23, 1988
Eaton Corporation	November 11, 1988
General Electric Company	November 8, 1988
Loral Corporation	February 24, 1989
Martin Marietta Corporation	November 24, 1988
Motorola, Inc.	November 19, 1988
The Boeing Company	November 23, 1988
The Dow Chemical Company	November 23, 1988
TRW Inc.	November 18, 1988

Letter B. Recipients

A.H. Robins Company, Inc.	
AEL Industries	January 31, 1989
Ashland Oil, Inc.	August 20, 1988
Beech-Nut Nutrition Corporation	
Browning-Ferris Industries, Inc.	September 23, 1988
E. I. DuPont de Nemours and Company	November 18, 1988
Eli Lilly and Company	November 14, 1988
Exxon Corporation	November 28, 1988
Fischbach Corporation	
General Dynamics Corporation	November 28, 1988
Gould Inc.	November 25, 1988
GTE Corp.	November 3, 1988

Harris Corporation	May 17, 1989
Itel Corp.	December 8, 1988
Litton Industries, Inc.	June 30, 1988
Lockheed Corporation	December 5, 1988
McDonnell Douglas Corp.	November 21, 1988
Monsanto Company	November 11, 1988
Morton Thiokol, Inc.	May 18, 1989
Nestle S.A.	
Northrop Corporation	November 30, 1988
Occidental Petroleum Corp.	December 19, 1988
Outboard Marine Corp.	August 5, 1988
Paradyne Corp.	December 5, 1988
Parker-Hannifin Corporation	May 29, 1989
Pennwalt Corp.	
PepsiCo Inc.	December 1, 1988
R.P. Scherer Corp	
Rockwell International Corporation	September 7, 1988
SmithKline Bechman Corporation	November 22, 1988
Sundstrand Corp.	November 9, 1988
Texas Eastern Corp.	November 10, 1988
The Goodyear Tire & Rubber Company	October 25, 1988
Union Carbide Corporation	November 17, 1988
Unocal Corporation	November 14, 1988
Varian Associates, Inc.	September 8, 1988
W. R. Grace & Co.	December 1, 1988
Westinghouse Electric Corporation	November 14, 1988

Statement of Robert M. Latta

Chief U. S. Probation Officer
Central District of California

United States Sentencing Commission Hearing
United States Courthouse
Pasadena, California
December 2, 1988

My comments will relate to the role of the probation service in carrying out the goals of organizational probation.

The two goals of organizational probation, as stated in the discussion materials, are to support monetary sanctions and to prevent repetition of criminal activities. There are three basic applications:

1. To enforce restitution, notice to victims, forfeitures and installment fines;
2. To support deterrent effect of fines by requiring financial supervision of an organization that is unable to pay the full amount of an appropriate fine;
3. Where an organization or its management has a history of serious crimes and supervision is likely to be useful in preventing future offenses, either by facilitating detection and prosecution or through compliance measures instituted by the organization. (This third option is more subjective and should be approached with caution.)

Overall it would appear that the proposed monetary sanctions, together with probation as an independent sanction, should greatly improve the criminal justice system's ability to deal more effectively with illegal behavior on the part of organizations.

In the past, monetary sanctions were often inadequate, and this fact alone caused courts throughout the country to fashion some of the creative sentences alluded to in the discussion

materials. The judges in the Central District of California have come up with their share of sentences which would have more meaning than a mere slap on the wrist.

The traditional job of the probation officer is to complete an investigation on individuals referred by the court to aid the court in fashioning an appropriate sentence and to supervise individuals in the community at the direction of the court or paroling authority. The education and training of probation officers prepare them to work with people on a one-to-one basis.

Federal probation officers are perhaps more experienced in supervising organizations than are their counterparts at the local level, because of the nature of federal crimes. However, their degree of competence is the result of on-the-job experience rather than formal training.

Even though individual officers may do a creditable job of supervising organizations, the probation service as a whole is not equipped to give effective supervision to complex business organizations. When the intention of the court is to enforce restitution, provide notice to victims, satisfy forfeiture agreements, and collect installment fines, then the probation officer can provide that service which the discussion materials describe as the first of three basic applications of organizational probation.

When community service is seen by the court as an appropriate sanction, this can be coordinated by the probation officer; however, staff assistance from the convicted organization

will be needed to work with the probation officer. When appropriate, the staff could be an employee of the organization; or, if not, then an individual compensated by the organization would work with the probation officer. There are currently many examples of this kind of arrangement throughout the federal courts.

The remaining two basic applications of organizational probation would appear to require the use of an expert, if the organization was at all complex.

In situations where an expert is used during the period of supervision, the expert should work through the probation officer and not independently of the probation officer. That person's monitoring reports and other written material should be submitted to the probation officer who then reports to the court.

The discussion materials speak to the appointment of a person other than the probation officer to prepare the presentence report in accordance with 18 USC 3552. Section 3552(a) specifies that a United States Probation Officer shall make a presentence investigation. Sections 3552(b) and (c) seem to refer to psychological or psychiatric examinations, rather than an organizational presentence investigation.

The present investigative expertise of United States Probation Officers should be sufficient to provide the court with the information necessary to properly sentence a corporation. Prior to sentencing, most individuals, as well as organizations, tend to be more forthcoming with information. It is after sentencing

and during a period of supervision that we will need expert assistance in complex cases.

One of the central aims of the proposed guidelines is to encourage voluntary compliance, and "it is anticipated that the corporation will normally take a leading role in proposing the conditions and internal controls that should be imposed." In my opinion, this is an overly optimistic view.

Another area of concern is the expected level of coordination among the civil and criminal authorities in this process. I cannot speak to the level of coordination prior to sentencing; however, once a sentence of probation is imposed, continued coordination is the exception, not the rule. In spite of good intentions, the burden of work and staff turnover mitigate against this kind of coordination.

As a final concern, I have found that, when a corporation and individual officer are both placed on probation, the level of compliance to the orders of the court are significantly enhanced. In my experience, it is not unusual for a corporate defendant to quickly file bankruptcy after receiving probation.

BEFORE

The United States Sentencing Commission
Pasadena, California

December 2, 1988

[A shareholder] may be innocent in fact, but socially he cannot be held innocent. He accepts the benefits of a system. It is his business and his obligation to see that those who represent him carry out a policy which is consistent with the public welfare. If he fails in that, so far as a stockholder falls in producing a result, that stockholder must be held absolutely responsible, except so far as it shall affirmatively appear that the stockholder endeavored to produce different results and was overridden by a majority.

The problems of making corporations meaningfully accountable for activity that society has determined to be unacceptable--criminal--have not yet been solved. Criminal conviction, hold pleas, and routine involvement by virtually all of the largest and finest American corporations have become commonplace. This both trivializes the relevance of society's determinations of what constitutes unacceptable activity and demoralize the citizenry in the face of continued inability to hold corporations meaningfully accountable to societal standards.

Why do corporations engage in criminal behavior? It has to be because, at some level, they find that the benefits outweigh the costs. Or, more likely, management finds that the benefits accrue to the corporation, while the costs are borne elsewhere. And those costs are enormous. One price-fixing case was

1 Institutional Shareholder Services, Inc. is a consulting firm that advises large institutional shareholders on corporate governance issues. Our clients are long-term investors. They believe that exercise of the rights of ownership can protect and enhance the value of their investments, and that as fiduciaries for the beneficial owners of the stock, they must do so when it is economically justified.

estimated to cost the affected population more than all of the robberies committed against individuals that year. Shareholders in particular bear the costs on both sides. As taxpayers, they pay the costs of the prosecution; as shareholders they pay the costs of the defense. The highest level of corporate management, however, pays very little. They almost never go to jail; in fact, they very seldom lose their jobs. The company pays the fines, which are seldom calculated to offset any gains, and the company pays the officer's legal fees. The business judgement rule and limitation on directors' liability restrict shareholders' ability to get the courts to order reimbursement for the payment of these expenses or the loss in share value.

From the point of view of the shareholder, particularly the large institutional investor, there no issue more important than establishing their capacity to require that corporations they invest in comply with the standards of criminal behavior established by society. Pension funds, in particular, who are the epitome of the long term investor, are held in trust for millions of working Americans who want to retire in a country that is, among other things, law abiding. It is clearly in their interests as shareholders and as citizens to make sure that the companies they invest in abide by the law.

Although there is great public concern over the existence and extent of corporate crime, there is remarkably little baseline scholarship--virtually no centralized sources of information, no agreement on terminology, and only the slightest sense that we are even now grasping the extent of the problem. The "scholarship" boils down to two studies--Sutherland's White Collar Crime, published in 1949, and the various collaborative works of Marshall Clinard and Peter Yeager, sponsored by the U.S. Department of Justice, including Illegal Corporate Behavior and Corporate Crime (1980). Illegal Corporate Behavior confirmed Sutherland's principal finding: corporations violate the law with great frequency. The 582 Corporations surveyed by Clinard and Yeager racked up a total of 1,554 crimes, with at least one sanction imposed against 371 corporations (63.7%) of the sample. And although 40% of the sample had no actions initiated against them, a mere 38 parent manufacturing corporations out of a total of 477--less than 10 percent--had ten or more actions instituted against them. These 38 recidivist corporations accounted for 740, or 48.2%, of all sanctions imposed against all parent manufacturing firms surveyed."³ In 1980, Fortune magazine surveyed 1,043 large companies and concluded that a "surprising" and "startling" number of them had been involved in "blatant illegalities". "Almost two years after the Fortune story, U.S.

³Mokhiber, Russell, Corporate Crime and Violence, Big Business and the Abuse of the Public Trust, (Sierra Club, 1988), pp. 18 and 19.

News & World Report conducted a survey of America's 500 largest corporations and found that '115 have been convicted in the last decade of at least one major crime or have paid civil penalties for serious misbehavior.'" (U.S. News defined "serious misbehavior" as criminal convictions or civil penalties or settlements in excess of \$50,000)."⁴ Recent concern over the extent of criminal activity in dealings with the Defense Department has been so pronounced as to require no further comment here.

There is a curious numbness and sense of resignation with the problems presented by corporate criminal activity. While no one condones it, no one seems to know what to do about it. There is almost an acceptance that corporate criminality may be part of the inevitable price for the undoubted benefits derived from large business organizations.

Pentagon and Justice Department officials have been eager to show they are cracking down on procurement fraud, especially in light of lengthy delays in a separate, much-publicized nationwide inquiry into bribery and influence-peddling involving contractors and prominent defense consultants. For example, just two days ago, Bruce Kovens, head of the Pentagon's criminal investigative office in Philadelphia, said that General Electric was included in the indictment of its subsidiary because the evidence showed that GE "was responsible for the wrong-doing" in its subsidiary. Kovens said the charges against the parent company show that Defense Department officials "are determined to conscientiously investigate and prosecute all offenders, not just small companies."

But, the applicability of criminal law constraints to corporations has been mired in apparent effort to treat artificial entities as if they were natural persons. "Did you ever expect a corporation to have a conscience, when it has no soul to be damned, and no body to be kicked?"⁵ Concludes one of the most astute current observers, "At first glance, the problem of corporate punishment seems perversely insoluble: moderate fines do not deter, while severe penalties flow through the corporate shell and fall on the relatively blameless."⁶

⁴Ibid.

⁵Edward, First Baron Thurlow 1731-1806, quoted in M. King, Public Policy and the Corporation (1977).

⁶Coffee, John C., Jr., "No Soul to Damn: No Body to Kick: An Unscandalized Inquiry into the Problem of Corporate Punishment," Michigan Law Review, Vol. 79, pp. 386 and 387, (1981) [Hereinafter--Coffee: Corporate Punishment].

Although many ingenious solutions have been suggested, including the "equity fine" (Coffee: Corporate Punishment, 413-424), one is ultimately forced to confront the reality"...that companies have two kinds of records: those designed to allocate guilt (for internal purposes), and those for obscuring guilt (for presentation to the outside world). When companies want clearly defined accountability, they can generally get it. That is what management theory is all about. Diffused accountability is not always inherent in organizational complexity; it is in considerable measure the result of a desire to protect individuals within the organization by presenting a confused picture to the outside world. One might say that courts should be able to pierce this conspiracy of confusion. Without sympathetic witnesses from within the corporation who are willing to help, this is difficult."⁷

Despite some efforts to place corporations "on probation," to require payments to societally useful causes, even to jail executives, it is plain that nothing presently being done is acceptably effective and that the problem is becoming more acute. One must simply raise the question as to whether society can indefinitely countenance a situation in which corporate crime is endemic.

Surely those with the largest interest in making societal and corporate interests compatible are the long-term owners. Unless they are able to develop a "cost effective" approach to the problems caused by corporate criminality on an *ad hoc* basis, some significant regulatory effort should be contemplated. There will always remain need for legal sanctions: "[S]ome executives abstain from bribery because they are afraid of being punished. Most abstain from bribery because they view it as immoral. One reason that they view it as immoral is that executives who bribe are sometimes punished and held to public scorn. Do away with criminal punishment and you do away with much of the sense of morality which makes self-regulation possible. Self-regulation and punitive regulation are, therefore, complementary rather than alternatives."⁸ And yet, "[T]he firm is better positioned than the state to detect misconduct by its employees. It has an existing monitoring system already focused on them, and it need not conform its use of sanctions to due process standards. Indeed, if the penalties are severe enough, the corporation has both the incentive and, typically, the legal right to dismiss any employee it even suspects of illegal conduct."⁹

⁷Braithwaite, John, Corporate Crime in the Pharmaceutical Industry, Routledge & Keegan Paul, 1984, p. 324.

⁸Ibid., p. 319.

⁹ Coffee: Corporate Punishment, p. 408.

Let's pause to consider the position of institutional shareholders. They have no interest in or competency to develop or proscribe internal corporate procedures. No matter how large their investment, the return cannot be large enough to justify any kind of meaningful involvement in day-to-day operation of the company. In any event, it is not appropriate for the shareholders to concern themselves with how a corporation devises information flows to assure that notice is received at the appropriate level of conduct likely to be deleterious to society, how a company develops incentive systems to assure that compliance with law has the clear and undivided attention of appropriate personnel, or what review structures are established to monitor, review, document and validate compliance with law are not the appropriate concern of the shareholder. Their concern is to hold managements accountable for their conduct of the business "within the rules," and to thus create an incentive for management to establish a structure ensuring that compliance with the law receives the highest priority. It is noteworthy that Professor Friedman's well known aphorism that management's sole obligation is to maximize the value of the firm is importantly conditioned that such be "within the rules." To put it simply, shareholders hire managers to run their business in a way that will encourage a supportive governmental and societal climate to capitalist enterprise.¹⁰ Increasing corporate criminal activity is hostile to an attitude of public support in the future. Conceivably, management has been so caught up in the pursuit of short term profit (institutional shareholders have their share of blame in this regard) that it has failed to grasp the utter unacceptability of a situation in which corporate criminal activity not only is rampant but apparently is beyond the power of any to abate. Shareholders need to make unmistakably clear to those they hire that continued corporate crime will not be tolerated.

Setting forth the conditions of eligibility for service on the Board of Directors appears uniquely appropriate for shareholder concern and by-law implementation. One of the most important mechanisms available to shareholders is the power to elect directors. Certainly, the power to elect directors includes the power to establish eligibility, and certainly, commitment to compliance with the criminal law is a legitimate criterion. The fact that slates of directors, in virtually all cases, are nominated by management and run without opposition makes establishment of eligibility criteria especially

¹⁰ "Through the generally more active participation of their shareholders, cooperatives also offer the consumer greater control over management decisions than is provided to shareholders in large corporations." Clinard, Marshall, Illegal Corporate Behavior and Corporate Crime (1980), at p. 325.

appropriate. The Board of Directors has the authority, indeed the responsibility, to promulgate basic corporate policies. Yet the trend these days is to limit their liability, removing them even further from accountability. "More active stockholder participation might force greater corporate compliance with the law in some areas, although, as we have pointed out, their primary concern is often corporate stock growth and dividends...Far reaching corporate reform, however, depends on altering the process and structure of corporate decisionmaking. Traditional legal strategies generally do not affect the internal institutional structure...At present few clear functions are usually specified for corporate boards of directors; they frequently have served as rubber stamps for management. If a functional relationship and responsibility to actual corporate operations were established, directors would be responsible not only for the corporate financial position and stockholder dividends but also for the public interest, which would include the prevention of illegal and unethical activities undertaken in order to increase profits."¹¹

Institutional Shareholder Services represents owners who are trying to find a way to act effectively to assure that "their" companies comport with society's determination of acceptable behavior. In that connection, we wrote the attached letter to our clients, enclosing the letters we sent to a number of corporations (also attached).

The thrust of the proposed by-law amendment is that directors are highly motivated to continue to be eligible to serve as directors of public companies; that they have the authority to establish policies requiring management to implement obedience to the law as a corporate priority; and that placing responsibility on directors assures that "the buck will stop somewhere". Consideration of the many ways that management might implement its mandate is beyond the scope of this paper; suffice it simply that many corporations have such in place at the present time and substantial learning and experience are available.¹²

¹¹ Clinard, Marshall op cit supra at p. 307

¹²Consider for example the following excerpts from "Taming the Giant Corporation," by Ralph Nader, Mark Green, and Joel Seligman, printed in Donaldson, Thomas and Werhane, Patricia H., Ethical issues in Business - A Philosophical Approach (Prentice Hall, 1988), pp. 429 and 430: "[T]he board should designate executives responsible for compliance with these laws and require periodic signed reports describing the effectiveness of compliance procedures. Mechanisms to administer spot checks on compliance with the principal statutes should be created.

Professor Christopher Stone's Where the Law Ends¹³ is perhaps the best known work on this general subject. He concludes that the suspension of directors is the most effective way of dealing with the problems of corporate criminality. "In general, though, I think it would be best if for all but the most serious violations we moved in the opposite direction, relaxing directors' liability by providing that any director adjudged to have committed gross negligence, or to have committed non-feasance [This translates to the enactment of policies to carry out our proposed new by-law] shall be prohibited for a period of three years from serving as officer, director or consultant of any corporation doing interstate business. Why is this better than what we have now? For one thing, the magnitude of the potential liability today has become so draconian that when we try to make the law tougher on directors the more likely effects are that corporate lawyers will develop ways to get around it, judges and juries will be disinclined to find liability, and many of the better qualified directors will refuse to get involved and serve. The advantages of the "suspension" provision, by contrast, are that it is not so easy to get around; it is not so severe that, like potential multi-million-dollar personal liability, it would strike courts as unthinkable to impose; but at the same time it would still have some effective bite in it -- the suspendees would be removed from the most prestigious and cushy positions ordinarily available to men of their rank, and would, I suspect, be object of some shame among their peers."

The limitations of the government in preventing and punishing corporate crime are all too plain. Neither the requirements nor the sanctions established by our laws reach those who make the decisions to engage in criminal activity, at least not forcefully enough to dissuade them. I believe that the object of sentencing guidelines in this area should be to promote internal mechanisms for accountability. That can best be accomplished in two ways. First, there should be a presumption that any criminal activity whose benefits are primarily reaped by the corporation (as opposed to criminal activity benefiting the individual, at the expense of the corporation, like embezzlement) is conducted with the consent of the corporation, and the highest level of the company should be held liable. Second, the structures in place for self-regulation at the corporation, should be a major factor in determining the appropriate sanctions. If, for example, the company has in place a by-law

Similar mechanisms can insure that corporate "whistle blowers" and nonemployee sources may communicate to the board - in private and without fear of retaliation - knowledge of violations of law."

¹³Stone, Christopher D., Where the Law Ends, The Social Control of Corporate Behavior, (Harper & Row, 1975) p. 148.

making individuals who permit the company to engage in criminal activity ineligible for director positions, a strong program for employee education and monitoring, and its own internal sanctions for either violating the law or allowing it to be violated, that would help to establish that any criminal activity was not attributable to the corporation itself and its directors. It is, in a way, a method for determining the corporate "mens rea," and as such is entirely appropriate to examine in determining sanctions.

November 7, 1988
Mr. Derek C. Bok
President
Harvard University
Massachusetts Hall
Cambridge, MA 02138

Dear Derek:

We have heard from many of our clients increasing concerns about corporate criminal behavior, and its impact on share value. The decision to violate the law occurs when, at some level, management finds that the benefits outweigh the costs. Or, more likely, management finds that the benefits accrue to the corporation, while the costs are borne elsewhere. The threat of criminal enforcement proceedings does not provide adequate incentives to obey the law, and we believe that shareholders can play a constructive and important role in creating appropriate incentives.

Employees, suppliers, non-government customers, all feel the impact when corporate resources are redirected from productivity and competitiveness to litigation defense. Shareholders in particular bear the costs on both sides. As taxpayers, they pay the costs of the prosecution; as shareholders they pay the costs of the defense. The highest level of corporate management, however, pays very little. They almost never go to jail; indeed, they very seldom lose their jobs. The company pays the fines, which are seldom calculated to offset any gains, and the company pays the officers' legal fees. The business judgment rule and limitation on directors' liability restrict shareholders' ability to get the courts to order reimbursement for the payment of these expenses or the loss in share value.

Even more disturbing than a criminal conviction is when management implicitly endorses the criminal activity afterward. For example, Morton M. Lippes was permitted to take Alleco private after he was convicted of a price-fixing scheme that resulted in record-breaking fines. Mr. Lippes is currently being investigated by a federal grand jury, the Securities and Exchange Commission and the IRS. He is being sued by shareholders to block his takeover of Alleco. Even if he did have the integrity and leadership to manage Alleco during this critical period, he just doesn't have the time.

Another example is Beech-Nut's violation of the food and drug laws. The president and vice president of Beech-Nut admitted that they knowingly permitted adulterated apple

juice to be sold in markets to be consumed by babies. The company pled guilty to 215 counts of federal food and drug violations, and paid a \$2 million fine. This has severely damaged its credibility. Even worse, its market share has dropped 15 percent as a result. This is a clear example of shareholder losses directly attributable to criminal conduct. It is reasonable for the shareholders to expect the directors to make sure that this kind of thing does not happen again.

Did the directors fire these men? On the contrary. They paid all of their legal fees, and they continue to pay their salaries, and have committed to do so until their appeals run out.

Shareholders can reasonably conclude that in doing so the directors have made it clear to the company's employees, its customers, and the community that it will tolerate, even support, the knowing sale of colored sugar water as apple juice, to be fed to babies. They have made it clear that they will tolerate, even support, actions that result in record-breaking criminal penalties. Shareholders can and should reasonably conclude that the directors have made it clear that they do not deserve the shareholders' support. And they should not give it.

We believe that management can send a strong signal to its employees and the community by insisting that its directors be responsible for preventing criminal behavior. A first step would be by adopting a policy or a by-law on the subject. We believe it should make ineligible for a position on the board anyone convicted of a felony in connection with his service on the board, or anyone who served on the board while the company was engaging in behavior leading to a criminal conviction. This would apply only if the crime was related to the central business activities of the corporation. We have identified two groups of companies as candidates for such a step; one group whose tradition of commitment to integrity and shareholder concerns indicates that they might be willing to be leaders in this area. The other group consists of companies whose record of criminal investigations makes them good candidates for an expression of shareholder concern.

We have written to both groups, enclosing suggested language for by-laws or policy statements. I am enclosing a list of the companies we wrote to, and samples of the language we suggested for the companies, depending on their line of business.

It is important to emphasize here that some infractions are inevitable. Laws and regulations are complex, and their

interpretation and enforcement vary enormously from one administration to another. Shareholders do not want companies to be so risk-averse that they always adopt the most conservative interpretation possible; sometimes it is worthwhile to challenge the law. And Congress has a tendency to react to a problem by making it criminal; Congress tries to appear to be cracking down on defense contractors and polluters, and does so by characterizing relatively minor violations as criminal. But directors must take the responsibility for setting some standards for the company.

Shareholders can protect and enhance the value of their holdings by making sure that corporate directors will not permit corporate crime. They do not have to sell out in disgust, or foot the additional bill for litigation. They can take the opportunity provided to them by the SEC to become informed about a company's risk of prosecution and use their proxies to make sure that the company has directors who will minimize that risk.

We urge you to read through the enclosed letters and the suggested by-laws. You may want to write to these companies yourself to endorse their adoption of such a by-law, or to send similar letters to other companies. If so, I hope you will send us copies. If the corporations who receive these letters are not responsive to these concerns, you might want to consider a shareholder resolution proposing the adoption of such a by-law yourself. I am enclosing a list of the deadlines for shareholder resolutions at these companies to assist you in doing so. We would be happy to help you to draft the resolutions, or to obtain support from other institutional shareholders.

Shareholders are affected by corporate criminal activity, and can take cost-effective action to demonstrate their concern and enhance value. I welcome your comments and suggestions on our proposals.

Sincerely,

Robert A. G. Monks

Encls.

LETTER A

October 26, 1988

Mr. Warren H. Phillips
Chairman of the Board
Dow Jones & Company, Inc.
200 Liberty Street
New York, NY 10281

Dear Mr. Phillips:

Institutional Shareholder Services, Inc. is a consulting firm that advises large institutional shareholders on corporate governance issues. Our clients are long-term investors with a substantial equity position in your company. They believe that exercise of the rights of ownership can protect and enhance the value of their investments, and that as fiduciaries for the beneficial owners of the stock, they must do so when it is economically justified.

Our clients are increasingly concerned about corporate crime, not just as a matter of public policy, but as a matter of investment policy. Companies that break the law incur huge legal fees and fines. They must devote enormous resources to preparing their defense. They lose goodwill in the community, and they lose business.

We have been impressed with your company's exemplary record, both in corporate governance and in making a commitment to the highest standards of ethical behavior. Our clients have demonstrated their support by buying and holding your stock. The latest figures we have show that institutions hold more than 8% of your shares. We would like you to go one step further in establishing your commitment to shareholder concerns and compliance with the laws by proposing the adoption of a by-law along the lines of the enclosed.

The by-law provides that any director who is convicted of a felony in connection with his or her service as a director will become ineligible for service on the Board. Similarly, any director serving at a time when the corporation is criminally convicted will also become ineligible for continued service (unless he or she voted against the conduct leading to the criminal conviction).

This by-law is intended to reach only the most extraordinary violations. It would not be triggered by criminal charges against corporate officers or employees (unless they also serve as directors). Some infractions are inevitable. Laws and regulations are complex, and their interpretation and enforcement vary enormously from one administration to another. Shareholders do not want companies to be so risk-averse that they always adopt the most conservative interpretation possible; sometimes it is worthwhile to challenge the law. And Congress has a tendency to react to a problem by making it criminal; Congress tries to appear to be cracking down on defense contractors and polluters, and does so by characterizing relatively minor violations as criminal. But directors must take the responsibility for setting some standards for the company.

The most important right granted to shareholders in exchange for their funds is the right to elect directors. That right carries with it the right to establish criteria for eligibility. The shareholders we work with would like to see you initiate action to adopt a policy or by-law along the lines of the enclosed draft to make it clear that you have a strong commitment to complying with the law, and a commitment to being responsive to shareholder concerns. We believe it would enhance your standing in the community and the value of their investment. We cannot see any possible case in which your company would want to retain a director covered by this by-law; adoption would simply make the removal automatic.

We would appreciate the opportunity to discuss this proposal with you. We are interested in your reaction, and we look forward to hearing from you.

Sincerely,

Robert A. G. Monks
President

Enclosure

**LIST OF ADDRESSEES FOR "LETTER A" CONCERNING PROPOSED
CORPORATE CRIMINAL ACTIVITY BY-LAW**

**Mr. Warren H. Phillips
Chairman of the Board
Dow Jones & Company, Inc.
200 Liberty Street
New York, NY 10281**

**Mr. Colby H. Chandler
Chief Executive Officer
Eastman Kodak Company
343 State Street
Rochester, NY 14650**

**Mr. John F. Welch, Jr.
Chairman of the Board
General Electric Company
3135 Easton Turnpike
Fairfield, CT 06413**

**Mr. Norman R. Augustine
Chairman and Chief Executive Officer
Martin Marietta Corporation
6801 Rockledge Drive
Bethesda, MD 20817**

**Mr. James R. Stover
President and Chief Executive Officer
Eaton Corporation
1111 Superior Avenue
Cleveland, OH 44114**

**Mr. Frank A. Shrontz
Chairman and Chief Executive Officer
The Boeing Company
P.O. Box 3707
Seattle, WA 98124**

**Dr. Ruben F. Mettler
Chief Executive Officer
TRW Inc.
1900 Richmond Road
Cleveland, OH 44124**

Mr. Frank P. Popoff
President and Chief Executive Officer
The Dow Chemical Company
2030 Willard H. Dow Center
Midland, MI 48674

Mr. George M.C. Fisher
President and Chief Executive Officer
Motorola, Inc.
1303 East Algonquin Road
Schaumburg, IL 60196

Mr. Bernard Schwartz
Chairman and Chief Executive Officer
Loral Corporation
600 Third Avenue
New York, NY 10016

October 26, 1988

Mr. Lawrence G. Rawl
Chairman and Chief Executive Officer
Exxon Corporation
1251 Avenue of the Americas
New York, NY 10020-1198

Dear Mr. Rawl:

Institutional Shareholder Services, Inc. is a consulting firm that advises large institutional shareholders on corporate governance issues. Our clients are long-term investors. They believe that exercise of the rights of ownership can protect and enhance the value of their investments, and that as fiduciaries for the beneficial owners of the stock, they must do so when it is economically justified.

Our clients are increasingly concerned about corporate crime, not just as a matter of public policy, but as a matter of investment policy. Companies that break the law incur huge legal fees and fines. They must devote enormous resources to preparing their defense. They lose goodwill in the community, and they lose business.

Our clients have expressed serious concerns about your commitment to compliance with the law. The latest figures we have show that institutions hold more than 33% of your shares. They are long-term investors; they would prefer not to sell out because of their concerns, especially since they believe that your poor record has depressed the stock. Their alternative, then, is to work with you to improve value. We would like you to establish your commitment to shareholder concerns and compliance with the laws by proposing the adoption of a by-law along the lines of the enclosed.

The by-law provides that any director who is convicted of a felony in connection with his or her service as a director will become ineligible for service on the Board. Similarly, any director serving at a time when the corporation is criminally convicted will also become ineligible for continued service (unless he or she voted

against the conduct leading to the criminal conviction).

This by-law is intended to reach only the most extraordinary violations. It would not be triggered by criminal charges against corporate officers or employees (unless they also serve as directors). Some infractions are inevitable. Laws and regulations are complex, and their interpretation and enforcement vary enormously from one administration to another. Shareholders do not want companies to be so risk-averse that they always adopt the most conservative interpretation possible; sometimes it is worthwhile to challenge the law. And Congress has a tendency to react to a problem by making it criminal; Congress tries to appear to be cracking down on defense contractors and polluters, and does so by characterizing relatively minor violations as criminal. But directors must take the responsibility for setting some standards for the company.

The most important right granted to shareholders in exchange for their funds is the right to elect directors. That right carries with it the right to establish criteria for eligibility. The shareholders we work with would like to see you initiate action to adopt a policy or by-law along the lines of the enclosed draft, to make it clear that you have a strong commitment to complying with the law, and a commitment to being responsive to shareholder concerns. We believe it would enhance your standing in the community and the value of their investment. We cannot see any possible case in which your company would want to retain a director covered by this by-law; adoption would simply make the removal automatic.

We would very much appreciate the opportunity to discuss this proposal with you. We are most interested in your reaction, and we look forward to hearing from you.

Sincerely,

Robert A. G. Monks
President

Enclosure

**LIST OF ADDRESSEES FOR "LETTER B" CONCERNING PROPOSED
CORPORATE CRIMINAL ACTIVITY BY-LAW**

**Mr. Alfred Manville
President and Chief Executive Officer
Fischbach Corporation
485 Lexington Avenue
New York, NY 10017**

**Mr. Lawrence G. Rawl
Chairman and Chief Executive Officer
Exxon Corporation
1251 Avenue of the Americas
New York, NY 10020-1198**

**Mr. Charles S. Locke
Chairman of the Board
Morton Thiokol, Inc.
110 North Wacker Drive
Chicago, IL 60606-1560**

**Mr. Harry J. Phillips, Sr.
Chairman and Chief Executive Officer
Browning-Ferris Industries, Inc.
P.O. Box 3151
Houston, TX 77253**

**Mr. Robert E. Mercer
Chairman of the Board
The Goodyear Tire & Rubber Company
1144 East Market Street
Akron, OH 44316-0001**

**Mr. Richard J. Stegemeier
President and Chief Executive Officer
Unocal Corporation
P.O. Box 7600
Los Angeles, CA 90051**

**Mr. Robert D. Kennedy
Chairman of the Board
Union Carbide Corporation
39 Old Ridgebury Road
Danbury, CT 06817-0001**

Mr. Thomas V. Jones
Chairman and Chief Executive Officer
Northrop Corporation
1840 Century Park East
Los Angeles, CA 90067

Mr. Larry O. Kitchen
Chairman and Chief Executive Officer
Lockheed Corporation
4500 Park Granada Boulevard
Calabasas, CA 91399

Mr. Richard D. Wood
President, Chairman and Chief Executive Officer
Eli Lilly and Company
Corporate Center
Indianapolis, IN 46285

Mr. Thomas D. Sege
Chairman and Chief Executive Officer
Varian Associates, Inc.
611 Hansen Way
Palo Alto, CA 94303

Mr. Paul G. Schloemer
President and Chief Executive Officer
Parker-Hannifin Corporation
17235 Euclid Avenue
Cleveland, OH 44112

Mr. Richard J. Mahoney
Chairman and Chief Executive Officer
Monsanto Company
800 N. Lindbergh Boulevard
St. Louis, MO 63167

Mr. John T. Hartley
Chief Executive Officer
Harris Corporation
1025 W. NASA Boulevard
Melbourne, FL 32919

Mr. Orion L. Hoch

Chairman and Chief Executive Officer
Litton Industries, Inc.
360 North Crescent Drive
Beverly Hills, CA 90210

Mr. J. Peter Grace
Chairman, President and
Chief Executive Officer
W. R. Grace & Co.
Grace Plaza
1114 Avenue of the Americas
New York, NY 10036-7794

Mr. John R. Hall
Chairman and Chief Executive Officer
Ashland Oil, Inc.
1000 Ashland Drive
Russell, KY 41169

Mr. Henry Wendt
Chairman of the Board
SmithKline Bechman Corporation
One Franklin Plaza
P.O. Box 7929
Philadelphia, PA 19101

Mr. Stanley C. Pace
Chairman and Chief Executive Officer
General Dynamics Corporation
Pierre Laclede Center
St. Louis, MO 63105

Mr. Richard E. Heckert
Chairman and Chief Executive Officer
E. I. DuPont de Nemours and Company
D 9000
1007 Market Street
Wilmington, DE 19898

SAMPLE BY-LAW FOR FOOD AND DRUG INDUSTRY VIOLATIONS

RESOLVED, that the by-laws of [] be amended by the adoption of a new Section [], to provide as follows:

"No person who is criminally convicted of a state or federal felony violation for causing death or serious bodily injury to any person by adulterating, misbranding, falsely labeling or falsely advertising a food, drug or device; or who is convicted of a felony violation for obstruction of justice, fraud, corruption of a public official, perjury, or making a false statement in furtherance of or to conceal any such activity; or who is convicted of conspiring to commit or aiding and abetting the commission of any violation described above; whether by trial, guilty plea, or plea of nolo contendere, shall be eligible to serve as a Director or Officer of the corporation for three years from the date of such conviction, unless and until such conviction is overturned or vacated by a court of competent jurisdiction.

If the corporation is criminally convicted of a state or federal felony violation for causing death or serious bodily injury to any person by adulterating, misbranding, falsely labeling or falsely advertising a food, drug or device; or is convicted of obstruction of justice, fraud, corruption of a public official, perjury, or making a false statement in furtherance of or to conceal any such activity; or is convicted of conspiring to commit or aiding and abetting the commission of any violation described above; whether by trial, guilty plea, or plea of nolo contendere, no person who, at the time of the conduct giving rise to the conviction was a Director of the corporation or was the President, Chairman, Chief Executive Officer, or Chief Operating Officer, or was a Vice President, Treasurer or Assistant Treasurer having responsibility for the area of corporate activity where such conduct occurred, and who had held that office for at least one year immediately prior thereto, shall be eligible to serve as a Director or Officer of the corporation for three years from the date of such conviction, unless and until such conviction is overturned or vacated by a court of competent jurisdiction. Provided, that if the corporate conduct giving rise to the conviction was the subject of a vote of the Board of Directors, then this provision shall not apply to any Director who cast his or her vote against such conduct.

Any disqualification effected by this by-law may be

removed by a vote of the holders in beneficial interest of 75% or more of the corporation's shares then outstanding."

SUPPORTING STATEMENT

The purpose of this resolution is to ensure that Directors and Officers are held accountable to shareholders for engaging in or allowing the corporation to engage in criminal conduct that goes to the heart of the corporation's activities. Criminal conduct of this nature, which threatens public health and safety, exposes the corporation to massive criminal fines and civil damage awards, and destroys corporate good will, is never in the best interest of the shareholders or the corporation, and should not be countenanced.

SAMPLE BY-LAW FOR ANTITRUST LAW VIOLATIONS

RESOLVED, that the by-laws of [] be amended by the adoption of a new Section [], to provide as follows:

"No person who is criminally convicted of a state or federal felony violation for price-fixing or other violation of the antitrust laws, or who is convicted of a felony violation for obstruction of justice, fraud, corruption of a public official, perjury, or making a false statement in furtherance of or to conceal any such activity; or who is convicted of conspiring to commit or aiding and abetting the commission of any violation described above; whether by trial, guilty plea, or plea of nolo contendere, shall be eligible to serve as a Director or Officer of the corporation for three years from the date of such conviction, unless and until such conviction is overturned or vacated by a court of competent jurisdiction.

If the corporation is criminally convicted of a state or federal felony violation for price-fixing or other antitrust violation, or is convicted of obstruction of justice, fraud, corruption of a public official, perjury, or making a false statement in furtherance of or to conceal any such activity; or is convicted of conspiring to commit or aiding and abetting the commission of any violation described above; whether by trial, guilty plea, or plea of nolo contendere, no person who, at the time of the conduct giving rise to the conviction was a Director of the corporation or was the President, Chairman, Chief Executive Officer, or Chief Operating Officer, or was a Vice President, Treasurer or Assistant Treasurer having responsibility for the area of corporate activity where such conduct occurred, and who had held that office for at least one year immediately prior thereto, shall be eligible to serve as a Director or Officer of the corporation for three years from the date of such conviction, unless and until such conviction is overturned or vacated by a court of competent jurisdiction. Provided, that if the corporate conduct giving rise to the conviction was the subject of a vote of the Board of Directors, then this provision shall not apply to any Director who cast his or her vote against such conduct.

Any disqualification effected by this by-law may be removed by a vote of the holders in beneficial interest of 75% or more of the corporation's shares then outstanding."

SUPPORTING STATEMENT

The purpose of this resolution is to ensure that Directors and Officers are held accountable to shareholders for

engaging in or allowing the corporation to engage in criminal conduct that goes to the heart of the corporation's activities. Criminal conduct of this nature exposes the corporation to massive criminal fines and civil damage awards, and destroys corporate good will, is never in the best interest of the shareholders or the corporation, and should not be countenanced.

SAMPLE BY-LAWS FOR DEFENSE PROCUREMENT VIOLATIONS

2.17 Qualification of Directors and Officers in the Event of Criminal Convictions.

No person who has been criminally convicted of a state or federal felony for

(a) defrauding the United States Government via one or more instances of cost misallocation, product substitution, failure to perform required tests, defective pricing, bid-rigging, or corruption of a public official,

(b) obstruction of justice, perjury or making a false statement in furtherance of or to conceal any activity described in (a) above,

(c) conspiring to commit or aiding or abetting the commission of any violation described in (a) or (b) above, or

(d) racketeering activity in which any of the violations described in (a), (b), or (c) above or state law bribery is an element,

whether by trial, guilty plea, or plea of nolo contendere, shall be eligible to be elected or to serve as an Officer or Director of the corporation for a period of three years from the date of such conviction, unless and until such conviction is overturned or vacated by a court of competent jurisdiction.

If the corporation is at any time criminally convicted of a state or federal felony violation for

(a) defrauding the United States Government via one or more instances of cost misallocation, product substitution, failure to perform required tests, defective pricing, bid-rigging, or corruption of a public official,

(b) obstruction of justice, perjury or making a false statement in furtherance of or to conceal any activity described in (a) above,

(c) conspiring to commit or aiding or abetting the commission of any violation described in (a) or (b) above, or

(d) racketeering activity in which any of the violations described in (a), (b), or (c) above is an element,

whether by trial, guilty plea, or plea of nolo contendere, no person who, at the time of the conduct giving rise to the conviction, was a Director of the corporation or was the President, Chairman, Chief Executive Officer, or Chief Operating Officer of the corporation, or who was a Vice-President, Treasurer, or Assistant Treasurer having responsibility for the area of corporate activity where such conduct occurred, and who had held such office for at least one year immediately prior thereto, shall be eligible to be elected or to serve as an Officer or Director of the corporation for a period of three years from the date of such conviction, unless and until such conviction is overturned or vacated by a court of competent jurisdiction. Provided, however, that if the corporate conduct giving rise to the conviction was the subject of a vote of the Board of Directors of the corporation, then this provision shall not apply to any Director who cast his or her vote against such conduct.

The felony offenses referred to in this by-law include, without limitation of any kind whatsoever upon the generality of the foregoing, violations of Title 18, United States Code, Section 201 (bribery), Sections 286 and 287 (fraudulent claims), Section 1001 (false statements), Section 1341 (mail fraud), Section 1343 (wire fraud), Section 1503, 1510, 1512 and 1513 (obstruction of justice), Section 1621 (perjury), Section 1952 (travel in aid of racketeering); Section 1962 (R.I.C.O.), Section 371 (conspiracy to defraud the United States), and Section 2 (aiding and abetting), and state law felony offenses involving the same or similar conduct.

A person affected by the operation of this by-law may be rendered eligible to be elected and to serve as a Director or Officer of the corporation prior to the expiration of the three year post-conviction period upon a vote in favor of such eligibility by the holders in beneficial interest of 75% or more of the corporation's shares then outstanding.

SUPPORTING STATEMENT

The purpose of this resolution is to ensure that Directors and Officers are held accountable to shareholders for engaging in or allowing the corporation to engage in criminal conduct that goes to the heart of the corporation's activities. Criminal conduct of this nature exposes the corporation to massive criminal fines and civil damage awards, and destroys corporate good will, is never in the best interest of the shareholders or the corporation, and should not be countenanced.

SAMPLE BY-LAW FOR ENVIRONMENTAL LAW VIOLATIONS

2.17 Qualification of Directors and Officers in the Event of Criminal Convictions.

No person who is criminally convicted of a state or federal felony violation for knowingly or recklessly endangering human health or the environment through the generation, disposal, storage, transportation, treatment or management of a hazardous substance; or who is convicted of a felony violation for obstruction of justice, fraud, corruption of a public official, perjury, or making a false statement in furtherance of or to conceal any such activity; or who is convicted of conspiring to commit or aiding and abetting the commission of any violation described above, whether by trial, guilty plea, or pleas of nolo contendere, shall be eligible to be elected or to serve as a Director or Officer of the corporation for a period of three years from the date of such conviction, unless and until such conviction is overturned or vacated by a court of competent jurisdiction.

If the corporation is at any time criminally convicted of a state or federal felony violation for knowingly or recklessly endangering human health or the environment through the generation, disposal, storage, transportation, treatment or management of a hazardous substance; or is convicted of a felony violation for obstruction of justice, fraud, corruption of a public official, perjury, or making a false statement in furtherance of or to conceal any such activity; or is convicted of conspiring to commit or aiding and abetting the commission of any violation described below, whether by trial, guilty plea, or plea of nolo contendere, no person who, at the time of the corporate conduct giving rise to the conviction, was a Director of the corporation, or was the President, Chairman, Chief Executive Officer, or Chief Operating Officer of the corporation, or was a Vice-President, Treasurer or Assistant Treasurer having responsibility for the area of corporate activity where such conduct occurred, and who had held such position for at least one year immediately prior thereto, shall be eligible to be elected or to serve as a Director or Officer of the corporation for a period of three years from the date of such conviction, unless and until such conviction is overturned or vacated by a court of competent

jurisdiction. Provided, however, that if the corporate conduct giving rise to the conviction was the subject of a vote of the Board of Directors of the corporation, then this provision shall not apply to any Director who cast his or her vote against such conduct.

The felony offenses referred to in this by-law include, without limitation, violations of Title 42, United States Code, Section 6928(d), or (e) (the Solid Waste Disposal Act), Title 49, United States Code, Section 1809(b) (the Hazardous Materials Transportation Act), Title 18, United States Code, Section 201 (bribery), Section 1001 (false statements), Section 1341 (mail fraud), Section 1343 (wire fraud), Sections 1503, 1510, 1512 and 1513 (obstruction of justice), Section 1621 (perjury), Section 371 (conspiracy to defraud the United States), Section 2 (aiding and abetting), and state law felonies involving the same or similar conduct.

A person affected by the operation of this by-law may be rendered eligible to be elected and to serve as a Director or Officer of the corporation prior to the expiration of the three year post-conviction period upon a vote in favor of such eligibility by the holders in beneficial interest of 75% or more of the corporation's shares then outstanding.

DEADLINES FOR SHAREHOLDER RESOLUTIONS

Letter A Recipients

Dow Jones & Company, Inc.	November 11, 1988
Eastman Kodak Company	November 23, 1988
Eaton Corporation	November 11, 1988
General Electric Company	November 8, 1988
Loral Corporation	February 24, 1989
Martin Marietta Corporation	November 24, 1988
Motorola, Inc.	November 19, 1988
The Boeing Company	November 23, 1988
The Dow Chemical Company	November 23, 1988
TRW Inc.	November 18, 1988

Letter B. Recipients

A.H. Robins Company, Inc.	
AEL Industries	January 31, 1989
Ashland Oil, Inc.	August 20, 1988
Beech-Nut Nutrition Corporation	
Browning-Ferris Industries, Inc.	September 23, 1988
E. I. DuPont de Nemours and Company	November 18, 1988
Eli Lilly and Company	November 14, 1988
Exxon Corporation	November 28, 1988
Fischbach Corporation	
General Dynamics Corporation	November 28, 1988
Gould Inc.	November 25, 1988
GTE Corp.	November 3, 1988

Harris Corporation	May 17, 1989
Itel Corp.	December 8, 1988
Litton Industries, Inc.	June 30, 1988
Lockheed Corporation	December 5, 1988
McDonnell Douglas Corp.	November 21, 1988
Monsanto Company	November 11, 1988
Morton Thiokol, Inc.	May 18, 1989
Nestle S.A.	
Northrop Corporation	November 30, 1988
Occidental Petroleum Corp.	December 19, 1988
Outboard Marine Corp.	August 5, 1988
Paradyne Corp.	December 5, 1988
Parker-Hannifin Corporation	May 29, 1989
Pennwalt Corp.	
PepsiCo Inc.	December 1, 1988
R.P. Scherer Corp	
Rockwell International Corporation	September 7, 1988
SmithKline Bechman Corporation	November 22, 1988
Sundstrand Corp.	November 9, 1988
Texas Eastern Corp.	November 10, 1988
The Goodyear Tire & Rubber Company	October 25, 1988
Union Carbide Corporation	November 17, 1988
Unocal Corporation	November 14, 1988
Varian Associates, Inc.	September 8, 1988
W. R. Grace & Co.	December 1, 1988
Westinghouse Electric Corporation	November 14, 1988



UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
WASHINGTON, D.C. 20460

OCT 14 1988

THE ADMINISTRATOR

Honorable Ilene H. Nagel
Commissioner, U.S. Sentencing Commission
1331 Pennsylvania Avenue, N.W.
Suite 1400
Washington, D.C. 20004

Dear Ms. Nagel:

Both personally and in my capacity as Administrator, I want to convey my appreciation for your letter of September 7, 1988 in which you solicited comments from this Agency concerning the draft sentencing guidelines for corporations and other organizational defendants convicted of federal criminal offenses. I also commend the Sentencing Commission and its support personnel who have ably performed the difficult and controversial task of formulating sentencing guidelines that will rectify some of the basic shortcomings that characterize federal sentencing practices.

As you recognized, there is a continuing debate on the issue of the appropriate role of probation in sentencing corporate offenders. I am familiar with the parameters of this debate as a consequence of my participation in the preparation of the White House Domestic Policy Council's (DPC) Principles of Corporate Sentencing, which were provided to the Sentencing Commission on April 5, 1988. On behalf of the Agency, I strongly advocated that Federal Courts be encouraged to use creatively their probationary powers to structure conditions of probation that are designed to enhance future compliance with the law by the immediate corporate offender and by similarly situated members of the regulated community. Contrary to this position and the recommendations of the DPC, Part D of the Draft Organizational Sentencing Guidelines specifies very restrictive circumstances under which federal judges can impose probation for the purpose of preventing future offenses. In addition, this same guideline section enumerates conditions of probation primarily designed to ensure full payment by the corporate defendant of financial penalties. Indeed, even if a corporate defendant were to meet all the criteria to warrant "curative" probation, the probation conditions for accomplishing this purpose must be of a nature,

pursuant to the commentary for that guideline section, as not to "terminate, restrict, or unduly burden any business operation," although this is precisely the incentive in most instances for committing environmental crimes.

I believe that the coupling of financial penalties with the use of the courts' probationary authority can best achieve what should be the dominant objective in sentencing corporations: the alteration of corporate behavior, both of the immediate violator and of other potential corporate wrongdoers. There are no other executive agencies that have broader regulatory enforcement oversight than the Environmental Protection Agency. Based on my experience with this Agency, I believe corporations should not be conceptually dealt with exclusively as inanimate entities. They should, to some extent, be treated as personalities that can be made responsive to behavioral sanctions. Fines are an effective form of punishment, but corporations, while on criminal probation, do find the means to be in scrupulous compliance with their environmental responsibilities. This sensitivity by management to the necessity of environmental compliance while on probation helps to establish this beneficial change in corporate behavior as a permanent part of that corporation's character. Toward this end, the Office of Criminal Enforcement Counsel distributes a court's order of probation to all concerned program offices so that they can be particularly watchful that all facilities of the corporate offender do remain in compliance.

Two premises are generally offered for not advocating corporate probation. One is that regulatory offenses are subject not only to criminal prosecution, but also to civil enforcement and administrative sanctions. To assume that during or after a criminal enforcement action civil and/or administrative sanctions will be pursued, overlooks the complexities involved in conducting parallel civil and criminal proceedings. It also disregards the practical reality that often, after either a civil or criminal enforcement action is concluded, there can be a lack of institutional motivation for initiating the other forms of enforcement action. In addition, the Government is subject to a claim by the offender of enforcement "overkill" by making a violation the subject of both forms of enforcement action. Plainly, pursuing criminal and then civil enforcement actions, or vice versa, also constitutes an inefficient use of finite Federal enforcement resources.

Secondly, corporate probation is too quickly dismissed due to the perception that it would result in extensive judicial supervision of business enterprises. I wholeheartedly agree that a sentencing judge should not become an ex officio member of a corporate board of directors. However, there are a wide variety of conditions of probation that would not require more than minimal judicial monitoring. Establishing these conditions,

just as suspending a portion of a fine as a condition of probation, can provide very powerful incentives for positive corporate change. In this regard, I believe the full review of the corporation's character, including size and ability to pay, should be presented to the court. The court will then be able to fashion a remedy that is both consistent with Sentencing Guidelines and that serves as a true deterrent for the convicted corporation and other like-minded entities.

I trust that the Sentencing Commission will revisit the subject of corporate probation and make a realistic and thorough analysis of both the deterrent and "rehabilitative" effect that can be achieved through creative use of corporate probation. I believe a strong case can be made for reducing inconsistency in sentencing corporations while maintaining the ability to "tailor the sentence to the character of the corporations for the maximum societal good."

Such an analysis will, I am certain, result in an alteration in the final guidelines that would make judicial consideration of imposing appropriate conditions of probation an integral part of the sentencing process for convicted corporations, just as it is for individual offenders. Assistant Administrator for Enforcement and Compliance Monitoring, Thomas L. Adams, Jr., will continue to provide whatever Agency support the Commission may require in performing this important task. A representative of the Agency will be pleased to accept your invitation to testify on this matter at the hearings to be held by the Sentencing Commission in December.

Sincerely,

Lee M. Thomas
Lee M. Thomas

cc: William W. Wilkins, Jr.

**INDIVIDUAL AND CORPORATE DEFENDANTS CONVICTED
OF ENVIRONMENTAL OFFENSES PRESENTLY ON PROBATION**

CASE NAME	DEFENDANT NAME	SENT ENTER DATE	MONTHS OF PROBATION
<u>EPA Region I</u>			
DERECKTOR SHIPYARD	ROBERT E. DERECKTOR	12/29/86	60.00
WATERBURY HOUSE WRECKING	MAURICE FABIANI	12/19/85	60.00
	PETER VILEISIS, JR.	12/19/85	60.00
MARATHON DEVELOPMENT CORP	TERRENCE GEOGHEGAN	5/04/88	12.00
<u>EPA Region II</u>			
WILL & BAUMER CANDLE MFG.	WILL & BAUMER, INC.	6/10/86	60.00
	DUANE SIMMONS	6/10/86	24.00
	FREDERICK C. KIESINGER	6/10/86	24.00
	HOWARD NYBO	6/10/86	24.00
JOSEPH TIETELBAUM	JOSEPH TIETELBAUM	7/30/87	24.00
<u>EPA Region III</u>			
FORMS, INC. / PHILLIP F.	TREMBLEY, PHILLIP	9/26/88	60.00
FREEMAN KRUM	FREEMAN Z. KRUM	6/10/87	18.00
ERNEST MARTIN'S JUNK YARD	SAMUEL RUNFOLA	4/19/88	36.00
	VIRGIL CUMMINGS	5/12/88	48.00
	ERNEST MARTIN	4/19/88	36.00
JARRETT'S WATER & WASTE W	FRANCIS SUSAN MOOSE	9/16/87	12.00
<u>EPA Region IV</u>			
CITY CHEMICALS CO.	ARTHUR J. GREER	9/15/86	60.00
PERFORMANCE ADVANTAGE/HAY	LYNDOL BOLTON	11/26/84	120.00
	LYNDOL BOLTON	11/26/84	60.00
	RAY KELLEY	4/16/87	12.00
MILLS, GEORGE	MILLS, GEORGE	1/29/85	60.00

CASE NAME	DEFENDANT NAME	SENT ENTER DATE	PROBATION
<u>EPA Region IV contd.</u>			
HEDRICK, JAMES H.	JAMES H. HEDRICK	3/14/85	36.00
	DONALD M. DRAPER	4/30/85	24.00
	DONALD M. DRAPER	9/27/85	24.00
	DONALD M. DRAPER	4/30/85	24.00
	DONALD M. DRAPER	9/27/85	24.00
	GEORGE GARY	12/01/86	24.00
	ARTHUR SCIULLO	12/01/86	24.00
SMITH, NORMAN F.	NORMAN F. SMITH	7/21/86	48.00
HOLLAND, JAMES L.	HOLLAND, JAMES L.	5/27/88	60.00
JOHN H. TAYLOR, JR.	JOHN H. BIDDLE	9/30/88	36.00
	JOHNNY M. CLARK	7/18/88	36.00
	JOHN H. MCDONALD	8/26/88	36.00
	DON A. SCRUGGS	8/30/88	24.00
	JOHNNY M. CLARK	7/18/88	36.00
<u>EPA Region V</u>			
SUERTH, JOHN	JOHN VAN HOESEN	1/16/85	36.00
	JOHN SUERTH	5/24/85	60.00
LAVIOLETTE, THOMAS D.	LAVIOLETTE, THOMAS D.	4/25/86	36.00
	RODERICK W. REISER	4/25/86	36.00
PACIESAS, PATRICK W.	PATRICK W. PACIESAS	9/28/87	24.00
	JOHN PLANTAN	7/25/88	24.00
JAY WOODS OIL, INC.	FRANK LYNCH	7/28/87	24.00
<u>EPA Region VI</u>			
ERICKSON CHEMICAL CO.	SHELTON ERICKSON	8/19/88	24.00
<u>EPA Region VII</u>			
MARITZ CORPORATION	MARITZ CORPORATION, INC.	3/23/84	60.00
	WILLIAM E. PIEBER	3/09/84	24.00
ROTH, ERIC D.	ERIC DONALD ROTH, SR.	9/06/85	60.00

CASE NAME	DEFENDANT NAME	SENT ENTER DATE	PROBATION
<u>EPA Region VII contd.</u>			
POLLOCK, MERLYN	MERLYN POLLOCK	11/09/87	24.00
MEYER, JOHN	JOHN MEYER	5/29/87	24.00
TWA, INC.	ARNOLD N. GRAHAM	9/18/86	60.00
REIDY TERMINAL, INC.	ANTHONY DEJOHN	9/04/87	36.00
	JAMES JOHNSON	9/11/87	36.00
<u>EPA Region VIII</u>			
DENVER SANITARY CO. INC	DENVER SANITARY CO., INC.	9/04/87	36.00
	ANDREW FEDOROWICZ	3/15/88	12.00
JAY L. HAMBURG	JAY L. HAMBURG	12/12/86	24.00
	NEIL MOSER	9/10/86	24.00
LEIGH-INDUSTRIES, INC.	GABRIEL DEMSHAR, JR.	8/14/87	24.00
PROTEX INDUSTRIES, INC.	PROTEX INDUSTRIES, INC.	3/04/88	60.00
	CHARLES VESTA HYATT	12/21/87	24.00
<u>EPA Region IX</u>			
NEVILLE CHEMICAL CO.	NEVILLE CHEMICAL CO.	11/24/86	36.00
DENNIS E. KIDWELL	DENNIS E. KIDWELL	6/11/86	60.00
CUSTOM ENGINEERING	BILL CLOSSON	5/09/87	60.00
	ROGER SCOGGINS	3/31/87	60.00
	JOHN SIDWELL	3/31/87	60.00
	PAUL CHAVEZ	6/03/88	24.00
U. S. TECHNOLOGY AND DISP	DARREL A. DUISAN	2/05/87	60.00
	GLEN D. FAULKS	2/05/87	60.00
	ROGELIO A. MARIN-SAGRISTO	2/05/87	60.00
	GEORGE SHEARER	2/05/86	60.00
CHEM-WOOD TREATMENT CO.	ERIE KITAGAWA	7/25/88	36.00
CUSTOM FOOD MACHINERY	CUSTOM FOOD MACHINERY	1/29/87	36.00
	RONALD MCNEIL	1/29/87	24.00
	EUGENE WELCH	1/29/87	24.00

CASE NAME	DEFENDANT NAME	SENT ENTER DATE	PROBATION
<u>EPA Region X</u>			
WYCKOFF COMPANY	WYCKOFF COMPANY, INC.	4/19/85	60.00
	WILLIAM C. CAIRNS	4/19/85	24.00
	DAVID G. CHEVALIER	4/19/85	24.00
	CHARLES D. HUDSON	4/19/85	24.00
	DONALD D. JOHNSON	4/19/85	24.00
DRUM RECOVERY, INC.	GARY VAN LOM	5/17/84	60.00
	EUGENE F. TIENKEN	5/17/84	60.00
	CHARLES TUTTLE	4/23/84	60.00
JANCO UNITED	PETER HEDEGARD	1/16/86	36.00
	ERIC MEYERS	1/16/86	36.00
EURO AUTO LTD.	JAMES S. STRECKER, JR.	9/03/87	60.00
	BARBARA A. STRECKER	9/04/87	12.00
MARINE POWER & EQUIPMENT	MARINE POWER & EQUIPMENT	4/10/87	36.00
	RICHARD C. WOECK	4/10/87	36.00
	PETER F. WOECK II	4/10/87	36.00
	LLOYD ANDERSON	4/10/87	36.00
SEA GLEANER MARINE INC.	SEA GLEANER MARINE INC.	10/03/86	60.00
	PAUL D. SCHWITTERS	10/06/86	12.00
PUYALLUP DISPOSAL	WENDALL WAYNE JOHNSON	5/16/86	36.00
NABISCO BRANDS, INC.	NABISCO BRANDS, INC.	9/12/86	60.00
	WILLIAM PARKS	7/18/86	36.00
ARGENT CHEMICAL LABORATORY	ARGENT CHEMICAL LABORATORY	3/31/88	60.00
	ELIOT L. LIEBERMAN	3/31/88	60.00
	BEATRIZ F. SHANAHAN	3/31/88	60.00
GEORGE SCOFIELD CO., INC.	GEORGE SCOFIELD COMPANY	7/13/88	36.00
	ROBERT SQUYRES	9/22/88	36.00
<u>EPA Region XI</u>			
MARDIKIAN, ALBERT AND	MARDIKIAN, ALBERT	10/21/85	60.00
	GARO MARDIKIAN	11/25/85	60.00
	SEMBAT AGOB	11/04/85	60.00
SOLID & LIQUID WASTE DISP	JERE NEIL ELLIS	6/27/88	24.00
WELCO PLATING, INC.	WELCO PLATING, INC.	4/27/88	60.00
	J.C. COLLINS	4/27/88	60.00

7-3-86 p/m

Franklin D. Burgess

FILED _____ ENTERED _____
 LODGED _____ RECEIVED _____

JUL 1 1986

JUL 8 1986

CLERK U.S. DISTRICT COURT
 WESTERN DISTRICT OF WASHINGTON
 DEPUTY

CLERK U.S. DISTRICT COURT
 WESTERN DISTRICT OF WASHINGTON AT TACOMA
 DEPUTY

UNITED STATES DISTRICT COURT
 WESTERN DISTRICT OF WASHINGTON
 AT TACOMA

8	UNITED STATES OF AMERICA,)	
)	
9	Plaintiff,)	NO. CR86-41T(FDB)
	v.)	
10)	
11	NABISCO BRANDS, INC.,)	JUDGMENT AND ORDER
)	OF PROBATION
12	Defendant.)	

13 On this 27th day of June, 1986, came the attorneys for the
 14 Government and the defendant Nabisco Brands, Inc., appeared
 15 through its counsel, Thomas E. Kelly, Jr., of Preston,
 16 Thorgrimson, Ellis & Holman.

17 IT IS ADJUDGED that the defendant upon its pleas of GUILTY,
 18 and the Court being satisfied there is a factual basis for the
 19 pleas, has been convicted of the offenses of violation of
 20 Title 33, United States Code, Section 1319(c)(1), as charged in
 21 Counts I and II of the Information, and the Court having asked
 22 the defendant's representative whether he has anything to say why
 23 judgment should not be pronounced, and no sufficient cause to the
 24 contrary being shown or appearing to the Court,

25 IT IS ADJUDGED that the defendant Nabisco Brands, Inc., is
 26 guilty as charged and convicted.

1 IT IS ADJUDGED as to Count I that defendant Nabisco shall be
2 fined the sum of FOUR HUNDRED FIFTY THOUSAND DOLLARS
3 (\$450,000.00), with the execution of ONE HUNDRED FIFTY THOUSAND
4 DOLLARS (\$150,000.00) of such fine suspended, and defendant
5 Nabisco placed upon probation on such Count, upon the following
6 terms and conditions, for such period as is necessary to
7 accomplish those conditions:

8 (1) Nabisco shall pay the sum of THREE HUNDRED THOUSAND
9 DOLLARS (\$300,000.00) as a fine payable to the Treasurer of the
10 United States on or before the tenth (10th) day following oral
11 pronouncement of judgment herein.

12 (2) Nabisco shall fund, in the amount of ONE HUNDRED FIFTY
13 THOUSAND DOLLARS (\$150,000.00) cash, on or before the tenth
14 (10th) day following oral pronouncement of judgment herein, an
15 Environmental Trust Fund, pursuant to a Declaration of Trust in a
16 form to be prepared by and wholly satisfactory to the
17 United States, to be managed by an appropriate financial
18 institution as Trustee (said institution to be selected by
19 counsel for the United States with the advice of the State of
20 Washington, Department of Fisheries and Department of Game), for
21 the benefit of the United States and the State of Washington for
22 the purpose of providing funds for the enhancement of fish and
23 game fish resources and hatcheries in the Stuck, White, and
24 Puyallup Rivers.

25 (3) The Environmental Trust Fund terms of trust shall
26 establish that the Fund is an irrevocable inter-vivos trust with

1 said financial institution as trustee (the Trustee). The terms
2 of trust shall grant the State of Washington Departments of
3 Fisheries and Game, through their offices of Habitat and
4 Management, an irrevocable, general power of appointment over
5 Fund income and corpus, to be exercisable by signed letter to the
6 Trustee. If for any reason the Heads of these State of
7 Washington offices are unable to concur concerning exercise of
8 said power of appointment, the Washington State Attorney General
9 shall have final authority to resolve any disagreements.

10 (4) Upon payment of the fine and the creation of the Trust
11 Fund, as set forth above, probation as to Count I shall terminate.

12 IT IS FURTHER ADJUDGED as to Count II that the imposition of
13 sentence shall be suspended and defendant Nabisco shall be placed
14 on probation for the term of three years, upon the following
15 terms and conditions:

16 (1) Nabisco shall comply with all Federal, State, and local
17 laws, including those related to environmental matters.

18 (2) In the event that any legal enforcement action by any
19 government agency is commenced against Nabisco for alleged
20 violations of Federal, State or local environmental laws, Nabisco
21 shall notify the United States Attorney for this District, in
22 writing, of said actions within fifteen (15) business days of
23 receipt of notice of such actions from the appropriate
24 authorities.

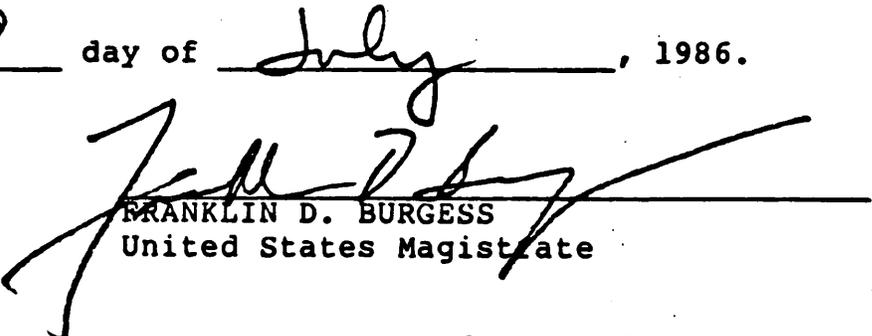
25 IT IS ORDERED that, pursuant to Title 18, United States
26 Code, Section 3013, defendant Nabisco shall pay the sum of Two

1 Hundred Dollars (\$200.00) as a mandatory penalty assessment to be
2 deposited in the Crime Victims Fund.

3 IT IS ORDERED that during the period of probation the
4 defendant shall conduct itself as a law-abiding, industrious
5 citizen and observe such conditions of probation as the Court has
6 prescribed. Otherwise, the defendant may be brought before the
7 Court for a violation of the Court's orders.

8 IT IS FURTHER ORDERED that the clerk deliver three certified
9 copies of this Judgment and Order to the probation officer of
10 this Court, one of which shall be delivered to the defendant by
11 the probation officer.

12 DATED this 8 day of July, 1986.

13
14 
15 FRANKLIN D. BURGESS
16 United States Magistrate

17 Presented by:

Approved as to form:

18 David V. Marshall
19 DAVID V. MARSHALL
Assistant United States Attorney

NABISCO BRANDS, INC.
By Preston, Thorgrimson,
Ellis & Holman,
authorized by corporate
resolution

20
21 Kathleen Mix
22 KATHLEEN MIX
Special Assistant U.S. Attorney
Assistant Attorney General for
23 the State of Washington
Department of Ecology
24 Olympia, Washington

Thomas E. Kelly, Jr.
THOMAS E. KELLY, JR.
For Preston, Thorgrimson,
Ellis & Holman
Attorneys for Defendant
Nabisco Brands, Inc.



UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
WASHINGTON, D.C. 20460

APR 14 1986

OFFICE OF
AIR AND RADIATION

MEMORANDUM

SUBJECT: Follow-up and Support to the Nabisco Brands Inc.
Criminal Case Settlement

FROM: John S. Seitz, Director *John S. Seitz*
Stationary Source Compliance Division
Office of Air Quality Planning and Standards

TO: Addressees

As the result of a criminal enforcement case filed under the Clean Water Act against a Nabisco Brands facility in Sumner, Washington, the Company agreed to a guilty plea for the unpermitted discharge of waste. As part of the settlement, Nabisco Brands is placed on probation for three years (July 1986 to July 1989) during which time the Company must comply with all Federal, State and local laws. The provision is applicable to all Nabisco Brands' facilities in the United States and applies to air regulations as well as water and other media. A copy of the settlement is attached for your information.

This precedent setting settlement provides an excellent opportunity for the results of an enforcement action in one media to assist in securing compliance with all environmental regulations for an entire corporation. Company facilities have received close monitoring for compliance by the water program during the past two years. EPA desires to evaluate compliance in other media during the remaining year of the probation.

To assist in assuring compliance with the probation agreement, we ask that you do three things. The first is to review the attached list of facilities in your Region to identify specific facilities that should be monitored. Secondly, please review any compliance information that you may have on these facilities to determine if any instances of non-compliance may have occurred during the probation period. Thirdly, please ensure that all Nabisco Brands facilities in your Region are inspected by EPA or the appropriate State agency prior to the end of the probationary period in July 1989.

The attached list of Nabisco Brand facilities was developed by the National Enforcement Investigations Center (NEIC) from EPA databases including CDS and FINDS. It is a preliminary list and should be verified against your records. Please note that facilities may be listed under a number of different subsidiary company names such as Del Monte, Lifesavers, Fleischmann Malting, Nabisco, Standard Brands, etc., as well as Nabisco Brands. Please review the list and provide any additions, deletions or corrections to NEIC by May 15, 1988, so that an accurate listing of Nabisco facilities subject to the probationary agreement may be maintained.

Please note that the facility list identifies those facilities that are regulated by the hazardous waste and water programs as well as the air program. Close monitoring by the water program will continue during the probationary period and monitoring by the hazardous waste program is being increased this year. You may want to coordinate with these programs to minimize the resources needed to ensure that all facilities are inspected during the probationary period.

Any information that you may have indicating that any of these facilities have been or are in non-compliance with environmental regulations (State or Federal) during the probationary period should be forwarded to NEIC who will follow up on compliance with the probationary agreement. Any inspection reports received during the next year that indicate non-compliance should be immediately brought to the attention of NEIC. The NEIC contact for this initiative is Mr. Jim Vincent. Please contact him at FTS 776-5120 to provide compliance information or if you have any questions or revisions of the facility list.

We appreciate your support of this special initiative to follow up on the probationary provisions of this criminal case.

Attachment

Addressees:

**Air Management Division Directors
Region I, III, and IX**

**Air and Waste Management Division Director
Region II**

**Air, Pesticides and Toxics Management Division Directors
Region IV and VI**

**Air and Radiation Division Director
Region V**

**Air and Toxics Division Directors
Regions VII, VIII, and X**

cc: Thomas P. Gallagher, Director, NEIC

Regional Counsels, Region I - X

**Thomas L. Adams, Jr., Assistant Administrator
for Enforcement and Compliance Monitoring**

**Paul R. Thomson, Jr., Deputy Assistant Administrator
Office of Criminal Enforcement Counsel/OECM**

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26

made to be a true and
correct copy of the original
137
July 8 1986 attest;

Deirdre L. Montoya
Deputy

9.3.86 p/m

Franklin D. Burgess

FILED	ENTERED
LOGGED	RECEIVED
JUL 1 1986	
AT SEATTLE CLERK U.S. DISTRICT COURT WESTERN DISTRICT OF WASHINGTON	
BY	
DEPUTY	
FILED	LOGGED
JUL 8 1986	
CLERK U.S. DISTRICT COURT WESTERN DISTRICT OF WASHINGTON AT TACOMA DEPUTY	

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF WASHINGTON
AT TACOMA

UNITED STATES OF AMERICA,)	
)	
Plaintiff,)	NO. CR86-41T(FDB)
v.)	
)	
NABISCO BRANDS, INC.,)	JUDGMENT AND ORDER
)	OF PROBATION
Defendant.)	

On this 27th day of June, 1986, came the attorneys for the Government and the defendant Nabisco Brands, Inc., appeared through its counsel, Thomas E. Kelly, Jr., of Preston, Thorgrimson, Ellis & Holman.

IT IS ADJUDGED that the defendant upon its pleas of GUILTY, and the Court being satisfied there is a factual basis for the pleas, has been convicted of the offenses of violation of Title 33, United States Code, Section 1319(c)(1), as charged in Counts I and II of the Information, and the Court having asked the defendant's representative whether he has anything to say why judgment should not be pronounced, and no sufficient cause to the contrary being shown or appearing to the Court,

IT IS ADJUDGED that the defendant Nabisco Brands, Inc., is guilty as charged and convicted.

a financial institution as trustee (the Trustee). The terms of the trust shall grant the State of Washington Departments of Fisheries and Game, through their offices of Habitat and Management, an irrevocable, general power of appointment over the trust income and corpus, to be exercisable by signed letter to the Trustee. If for any reason the Heads of these State of Washington offices are unable to concur concerning exercise of the power of appointment, the Washington State Attorney General shall have final authority to resolve any disagreements.

(4) Upon payment of the fine and the creation of the Trust as set forth above, probation as to Count I shall terminate.

IT IS FURTHER ADJUDGED as to Count II that the ~~probation~~ of sentence shall be suspended and defendant Nabisco shall be placed on probation for the term of three years, upon the following terms and conditions:

(1) Nabisco shall comply with all Federal, State, and local laws, including those related to environmental matters.

(2) In the event that any legal enforcement action by any government agency is commenced against Nabisco for alleged violations of Federal, State or local environmental laws, Nabisco shall notify the United States Attorney for this District, in writing, of said actions within fifteen (15) business days of receipt of notice of such actions from the appropriate authorities.

IT IS ORDERED that, pursuant to Title 18, United States Code, Section 3013, defendant Nabisco shall pay the sum of Two

it to be

us

urt has

e the

rtified

of

nt by

e

NABISCO FACILITIES WITH AIR PROGRAM IDENTIFIERS -- March 9, 1988 -- Page 1

EPA ID NUMBER	FACILITY NAME STREET ADDRESS CITY STATE ZIP CODE	EPA DATA SYSTEM	SOURCE ID NUMBER	PERMIT PROGRAM	PERMIT ID NUMBER
---------------	--	-----------------------	---------------------	-------------------	---------------------

REGION I

MAD037097292	MERCKENS CHOCOLATE NABISCO CONFECTIONS 150 OAKLAND ST MANSFIELD, MA 02048	CDS HMDMS PCS PCS	22212100032 MAD037097292 MA0005151 MA0021024	EPA NPDES EPA NPDES	MA0005151 MA0021024 (IU)
	NABISCO BRANDS, INC. WILTON EXECUTIVE CAMPUS	CDS	07026508834		

REGION II

NJD002373330	DEL MONTE CORPORATION PLANT NO 505 3RD AND CHURCH ST PO BOX 97 SWEDESBORO, NJ 08085	DOCKET HMDMS CDS	02-77-E012 NJD002373330 31176000018		
NJD981488158 NJD981490949	DEL MONTE USA PLANT 506 LOCKE AVENUE PO BOX 97 SWEDESBORO, NJ 08085	HMDMS CDS	NJD981488158 31176000044		
NJD001368109	NABISCO INC 2111 ROUTE 208 FAIR LAWN, NJ 07410	STATE PCS CDS HMDMS CERCLA	NJCF00345 NJ0002577 31030000109 NJD001368109 NJD001368109	EPA NPDES OTHER EPA	NJ0002577 RCSICNJ01937
	STANDARD BRANDS, INC. 16TH & RIVERFRONT HOBOKEN, NJ	CDS	31224000009		
NYD071081673	LIFE SAVERS INC. CHURCH STREET CANAJOHARIE, NY 13317	HMDMS STATE CDS	NYD071081673 LNYD071081673 33440000030		
NYD001397876	LIFE SAVERS, INC. NORTH MAIN STREET PORT CHESTER, NY 10573	STATE STATE CDS CDS HMDMS	E15548010149 TH2065757001 MED3373200149 33732060017 33732000017 NYD001397876	EPA PSD	NED3373200149

NABISCO FACILITIES WITH AIR PROGRAM IDENTIFIERS -- March 9, 1988 -- Page 2

NYD002123479	NABISCO INC 920 ERIE AVENUE NIAGARA FALLS, NY 14302	CDS 33472000036 HWDMS NYD002123479		
NYD001392372	STANDARD BRANDS INC CHARLES POINT PEEKSKILL, NY 10566	HWDMS NYD117327544 CDS 33732000044 CDS NED3373201155	EPA PSD	NED3373201155
PRD091007252	LIFE SAVERS MANUFACTURING INC ROUTE#30 KM 21 2 POST OFFICE BOX 128 LAS PIEDRAS, PR 00671	HWDMS PRD091007252 PCS PR0023248 CDS 40152000010 CDS 40152060004	EPA NPDES	PR0023248

REGION III

MDD043373885	NABISCO BRANDS (STANDARD BRANDS) 1900 BRAND AVE. BALTIMORE, MD 21209	PCS MD0002101 CDS 21012000754	EPA NPDES	MD0002101
PAD980250724	NABISCO INC ROOSEVELT BLVE & BYBERRY RD PHILADELPHIA, PA 19154	CDS 39716003201 HWDMS PAD980250724 PCS PA0044563	EPA NPDES	PA0044563
VAD007474393	NABISCO BRANDS INC 6002 S. LABURNUM AVE. RICHMOND, VA 23231	HWDMS VAD007474393 CDS 48150000083		
VAD041286642	STANDARD BRANDS PLANTERS PEANUTS 200 JOHNSON AVE SUFFOLK, VA 23434	HWDMS VAD041286642 CDS 48308000001 CDS 48308000017		

REGION IV

	COLUMBIAN PEANUT CHESTNUT STREET ALLANDER, NC 27805	CDS 34032000039		
	NABISCO, INC. 1400 MURPHY AVE. ATLANTA, GA 30293	CDS 11226000197		
GAD003273414	NABISCO WOODBURY GROCERY PLT 215 PIMIENTO DR. WOODBURY, GA 30293	PCS 6A0000876 DOCKET 04-77-E007 HWDMS GAD003273414 CDS 11360000011	EPA NPDES	6A0000876

TND066507534	PLANTERS SNACKS 3002 JERSEY PIKE PO BOX 21927 CHATTANOOGA, TN 37421	CDS HWDMS	44128002270 TND066507534
--------------	--	--------------	-----------------------------

REGION V

	DEL MONTE CORP. PLT 111 MAPLEWOOD AVENUE DEKALB, IL 60115	CDS	14180000009		
ILT180013880	DEL MONTE CORP PLT 115 15TH ST AND 4TH AVE PO BOX 89 ROCHELLE, IL 61068	PCS PCS HWDMS CDS	IL0003115 IL0003417 ILT180013880 14578001005	EPA NPDES EPA NPDES	IL0003115 IL0003417
ILD085227486	DEL MONTE CORP 2009 MAPLEWOOD AVE DE KALB, IL 60115	CDS HWDMS PCS	14180000009 ILD085227486 IL0003166	EPA NPDES	IL0003166
ILD005456678	DEL MONTE CORP LINCOLN AVE & 15TH ST ROCHELLE, IL 61068	CDS	14578001005		
ILD005453204	DEL MONTE CORP RTE 34 PLT 112 MENDOTA, IL 61342	CDS CDS HWDMS	14410000003 14410000051 ILD005453204		
ILD02514959	FLEISCHMAN MALTING 2143 W 51 PLACE CHICAGO, IL 60609	CDS	1415400021		
ILD067553541	LIFE SAVERS INC NABISCO BRANDS INC 3401 MT PROSPECT RD FRANKLIN PARK, IL 60131	CDS CDS HWDMS	14154000725 14154000463 ILD06755341		
ILD980795082	NABISCO BRANDS INC 4801 S OAKLEY CHICAGO, IL 60609	CDS	14154000376		
ILD021159934	NABISCO CONFECTIONS CO INC 805 N GRIFFIN DANVILLE, IL 61832	CDS	14778000007		
ILD049825540	NABISCO INC CEREAL PLT 1555 W OGDEN AVE MAPERVILLE, IL 60540	CDS	14198000028		

NABISCO FACILITIES WITH AIR PROGRAM IDENTIFIERS -- March 9, 1986 -- Page 4

ILD005521091	NABISCO INC CHICAGO BAKERY 7300 S KEDZIE AVE CHICAGO, IL 60629	CDS HWDMS	14154002107 ILD005521091		
ILD079155446	NABISCO INC MARSEILLES PLT FEDERAL PAPERBOARD CO., INC. 240 MAIN ST MARSEILLES, IL 61341	CDS HWDMS PCS DOCKET	14410001009 ILD079155446 IL0002488 05-78-E069	EPA NPDES	IL0002488
ILD980700611	STANDARD BRANDS INC 2133 W PERSHING RD CHICAGO, IL 60609	CDS	14154000556		
IND017764317	DEL MONTE CORP USA 506 W NORTH ST PLYMOUTH, IN 46563	HWDMS PCS CDS	IN0000230 15266000032	EPA NPDES	IN0000230
MND006452643	FLEISCHMANN MALTING CO INC 171 2ND ST NE MINNEAPOLIS, MN 55415	CDS	24148000037		
MND039131966	FLEISCHMANN MALTING CO INC 1717 2ND ST NE MINNEAPOLIS, MN 55413	HWDMS CDS	MND039131966 24148000037		
OH0005041864	NABISCO INC 2221 FRONT ST TOLEDO, OH 43605	CDS FATES	36372000070		
WID046534210	DEL MONTE CORP PLT 106 PO BOX 737 PLOVER, WI 54467	HWDMS CDS	WID046534210 51288000019		
WID981197866	DEL MONTE CORP PLT 107 CO TRUCK HIGHWAY B PLOVER, WI 54467	CDS HWDMS	51288000020 WID981197866		

REGION VI

LAD008149569	STANDARD BRANDS, INC 5500 CHEF MENTEUR HWY NEW ORLEANS, LA	CDS	19214000053		
--------------	--	-----	-------------	--	--

REGION VII

	NABISCO BRANDS, INC. WALL-ROGALSKY MILLING MCPHERSON, KS	CDS	17220000021
	NABISCO BRANDS, INC. ADM MILLING CO. BUHLER, KS	CDS	17306000025
MOD007157688	NABISCO INC 323 MERIDIAN CARTHAGE, MO 64836	CDS	26226000011

REGION IX

CAD981371727	DEL MONTE 2716 E MINER AVE STOCKTON, CA 95205	HWDMS CDS	CAD981371727 05696002004
CAD981675903 CAD077366177	DEL MONTE CORP PLANT #1 4000 YOSEMITE BLVD MODESTO, CA 95354	HWDMS CDS CDS HWDMS	CAD981675903 05802000046 05802075013 CAD077366177
CAD009165796	DEL MONTE CORPORATION 3100 E 9TH ST PO BOX 7121 OAKLAND, CA 94601	HWDMS CDS	CAD009165796 05006000086
CAD981165525	DEL MONTE USA STOCKTON #233 2716 E MINER STOCKTON, CA 95208	HWDMS CDS	CAD981165525 05696002004
CAD980380372	NABISCO BRANDS, INC. 1500 E 3RD STREET Oxnard, CA 93030	CDS	05850000016
CAD078755394	STANDARD BRANDS 501 DEHARD ST SAN FRANCISCO, CA 94107	CDS	05688000408
CAD095136009	STANDARD BRANDS 4300 W 19TH STREET TORRANCE, CA 90509	CDS	05420086008

NABISCO FACILITIES WITH AIR PROGRAM IDENTIFIERS -- March 9, 1988 -- Page 6

Facility ID	Company Name	Address	City, State, ZIP	Program	Identifier	EPA NFEIS	Identifier
HID009165754	DEL MONTE CORP	500 SUMNER ST	HONOLULU, HI 96821	PCS CDS	HI0000051 12014000027	EPA NFEIS	HI0000051
HID981638042	DEL MONTE HAWAIIAN OPERATIONS	94-1000 KUNIA RD	KUNIA, HI 96759	HWDMS CDS	HID981638042 12014000072		
<u>REGION X</u>							
ORD007908429	BEAR CREEK CORP.	DBA HARRY & DAVID	2518 S PACIFIC HWY MEDFORD, OR 97501	PCS CDS	OR0000973 38084000079		
	DEL MONTE CORP	1621 SPRUCE STREET	LA GRANDE, OR 97850	CDS	38180000031		
ORD088600671	DEL MONTE CORP PLT 126	PO BOX 790	SALEM, OR 97308	PCS CDS	OR0001066 38114005837		
ORD009048828	NABISCO BRANDS USA	100 NE COLUMBIA BLVD	PORTLAND, OR 97208	HWDMS STATE CDS	ORD009048828 ORD009048828 38124002968		
ORD009043258	HERVIN CO., THE	P.O. BOX 309	TUALITIN, OR 97062	PCS CDS	OR0000051 38186001893		
WAD009068644	NATIONAL BISCUIT CO	601 1ST ST	CHENEY, WA 99004	CDS	49206000009		

UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
REGION V

DATE: MAY 16 1988

SUBJECT: Follow-up and Support to the Nabisco Brands Inc.
Criminal Case Settlement

FROM: David Kee, Director 
Air and Radiation Division (5AC-26)

TO: John S. Seitz, Director
Stationary Source Compliance Division (EN-341)

A review of the attached list of Nabisco Brands Inc., facilities and its subsidiaries in Region V, revealed that all of the companies are presently in compliance with Federal, State and local air regulations.

However, our review also revealed that one source did operate in non-compliance during the probationary period. The Nabisco facility located at 7300 South Kedzie Avenue, Chicago, Illinois, stack tested the Incinerator/Waste Heat Boiler system on December 10, 1985; and the results indicated that they did not comply with applicable carbon monoxide and particulate regulations. The facility did some modifications and retested on June 25, 1986. The results of the test indicated compliance with particulate, but non-compliance with carbon monoxide.

A stack test just for carbon monoxide was conducted on December 13, 1986, and the results indicated compliance. In early 1987, Nabisco decided to shutdown the incinerator because it was economically not feasible to operate.

Corrections and deletions have been made to the list, and a copy of your memorandum will be forwarded to State and local agencies to ensure that all sources will be inspected during the probationary period.

Attachment

TND066507534 PLANTERS SNACKS CDS 44128002270
 3002 JERSEY PIKE HWDMS TND066507534
 PO BOX 21927
 CHATTANOOGA, TN 37421

REGION V

— DUPLICATE —	DEL MONTE CORP. PLT 111 MAPLEWOOD AVENUE DEKALB, IL 60115	CDS	14180000009		
ILT180013880	DEL MONTE CORP PLT 115 15TH ST AND 4TH AVE PO BOX 89 ROCHELLE, IL 61068	PCS PCS HWDMS CDS	IL0003115 IL0003417 ILT180013880 14578001005	EPA NPDES EPA NPDES	IL0003115 IL0003417
ILD085227486	DEL MONTE CORP 2009 MAPLEWOOD AVE DE KALB, IL 60115	CDS HWDMS PCS	14180000009 ILD085227486 IL0003166	EPA NPDES	IL0003166
— DUPLICATE —	DEL MONTE CORP LINCOLN AVE & 15TH ST ROCHELLE, IL 61068	CDS	14578001005		
—	DEL MONTE CORP RTE 34 PLT 112 (State Route 34 East) MENDOTA, IL 61342	CDS CDS HWDMS	14410000003 14410000003 ILD005453204		
ILD02514959	FLEISCHMAN MALTING 2143 W 51 PLACE CHICAGO, IL 60609	CDS	1415400021		
ILD087553541	LIFE SAVERS INC NABISCO BRANDS INC 3401 MT PROSPECT RD FRANKLIN PARK, IL 60131	CDS CDS HWDMS	14154000725 14154000725 ILD08755341		
ILD980795082	NABISCO BRANDS INC 4801 S OAKLEY CHICAGO, IL 60609	CDS	14154000576		
—	NABISCO CONFECTIONS CO INC (The Crutcher Co) 905 N GRIFFIN DANVILLE, IL 61832		14778000007		
ILD049825540	NABISCO INC CEREAL PLT 1555 W OGDEN AVE NAPERVILLE, IL 60540	CDS	14198000028		

ILD005521091	NABISCO INC CHICAGO BAKERY 7300 S KEDZIE AVE CHICAGO, IL 60629	CDS HWDMS	14154002107 ILD005521091		
ILD079155446	NABISCO INC MARSEILLES PLT FEDERAL PAPERBOARD CO., INC. 240 MAIN ST MARSEILLES, IL 61341	CDS HWDMS PCS DOCKET	14410001009 ILD079155446 IL0002488 05-78-E069	EPA NPDES	IL0002488
— DOES NOT EXIST—	ILD980700611 STANDARD BRANDS INC 2133 W PERSHING RD CHICAGO, IL 60609	CDS	14154000556		
IND017764317	DEL MONTE CORP USA 506 W NORTH ST PLYMOUTH, IN 46563	HWDMS PCS CDS	IN0000230 15266000032	EPA NPDES	IN0000230
— DUPLICATE —	MND006452643 FLEISCHMANN MALTING CO INC 171 2ND ST NE - incorrect address MINNEAPOLIS, MN 55415	CDS	24148000037		
MND039131966	FLEISCHMANN MALTING CO INC 1717 2ND ST NE MINNEAPOLIS, MN 55413	HWDMS CDS	MND039131966 24148000037		
OH0005041884	NABISCO INC 2221 FRONT ST TOLEDO, OH 43605	CDS FATES	36372000070		
WID046534210	DEL MONTE CORP PLT 106 PO BOX 737 PLOVER, WI 54467	HWDMS CDS	WID046534210 51288000019		
WID981197866	DEL MONTE CORP PLT 107 CO TRUCK HIGHWAY B PLOVER, WI 54467	CDS HWDMS	51288000020 WID981197866		

REGION VI

LAD008149569	STANDARD BRANDS, INC 5500 CHEF MENTEUR HWY NEW ORLEANS, LA	CDS	19214000053		
--------------	--	-----	-------------	--	--

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO

Criminal Action No. 87-CR-115-1

UNITED STATES OF AMERICA,

Plaintiff,

v.

PROTEX INDUSTRIES, INC.,

Defendant.

FILED
UNITED STATES DISTRICT COURT
DENVER, COLORADO

MAR 24 1988

JAMES R. MANSPEAKER
CLERK

JUDGMENT AND SENTENCING ORDER

The defendant corporation appeared in this court for sentencing on March 4, 1988, represented by its attorneys David Palmer of Gibson, Dunn & Crutcher, and Paul Phillips and Cindy Leap of Holland and Hart. The government was represented at the sentencing hearing by Kenneth Fimberg and Douglas Curless.

Upon the jury's unanimous verdicts of guilty found on December 21, 1987, as to Counts I, II, III, V, VI, VII, VIII, IX, XII, XIII, XIV, XV, XVI, XVII, XVIII and XIX, the defendant corporation has been convicted of the following offenses:

1. On Count I - conspiracy to violate environmental laws in violation of Title 18 U.S.C. § 371;
2. On Counts II, III, V and VI - false statements in violation of Title 18 U.S.C. § 1001;
3. On Counts VII, VIII, IX, XII and XIII - illegal disposal of hazardous waste in violation of Title 42, U.S.C. § 6928(d)(2)(A) and Title 18 U.S.C. § 2;

4. On Counts XIV and XVI - illegal storage of hazardous waste in violation of Title 42 U.S.C. § 6928(d)(2)(A) and Title 18 U.S.C. § 2;
5. On Count XV - illegal discharge of hazardous waste in violation of Title 33 U.S.C. § 1311(a) and 1319(c)(1) and Title 18 U.S.C. § 2; and
6. On Counts XVII, XVIII and XIX - knowing endangerment in violation of Title 42 U.S.C. § 6928(e).

IT IS THE JUDGMENT OF THIS COURT THAT:

The court finds as facts that the victims of these offenses are Terry Baumgartner, Richard Tice, Robert Evans, and the People of the City and County of Denver, Colorado and of the State of Colorado. Having reviewed and reconsidered the evidence at trial, my notes from the trial, the testimony and reports from the medical witnesses, and all documents submitted and admitted in evidence by both parties in connection with the sentencing process, I find that the three individual victims have incurred injuries and losses, for which they are entitled to restitution, of not less than the following amounts, respectively:

1. Terry Baumgartner: \$350,000.00.
2. Richard Tice: \$325,000.00.
3. Robert Evans: \$275,000.00.

I further find and conclude that the People of the City and County of Denver and the State of Colorado, and those political entities, have incurred injuries and losses in the form of the defendant's having placed in their midst a dangerous hazardous waste site and having inflicted on them the expense and burden to clean up that site, the location of the defendant's plant in

Denver, at a cost estimated at over \$2,000,000.00.

Count I.

It is ordered as to Count I that the defendant corporation pay a fine of \$500,000.00 to the United States. The execution of all but \$50,000.00 of that fine is suspended and the defendant corporation is placed on probation for a period of five years, on the following terms and conditions: 1) that the defendant corporation promptly and fully pay the victim restitution below ordered as part of this sentence, 2) that the defendant corporation promptly and fully perform its obligations to clean up the land where it previously conducted business to meet the standards of the U.S. Environmental Protection Agency and the Colorado Department of Health, and 3) that the defendant corporation fully cooperate with the Probation Department and perform all terms and conditions of the probation imposed by this court, including payment of restitution. The defendant corporation immediately shall pay \$200.00 to the Crime Victim Fund pursuant to Title 18 U.S.C. § 3013.

Count II.

It is ordered as to Count II that the defendant corporation pay a fine of \$10,000.00 to the United States. Execution of that fine is suspended and the defendant corporation is placed on probation for a period of five years, on the following terms and conditions: 1) that the defendant corporation promptly and fully pay the victim restitution below ordered as part of this sentence, 2) that the defendant corporation promptly and fully perform its obligations to clean up the land where it previously conducted business to meet the standards of the U.S. Environmental Protection Agency and the Colorado Department of Health, and 3) that the defendant corporation fully cooperate with the Probation Department and perform all terms and conditions of the

probation imposed by this court, including payment of restitution.

Count III.

It is ordered as to Count III that the defendant corporation pay a fine of \$10,000.00 to the United States. Execution of that fine is suspended and the defendant corporation is placed on probation for a period of five years, on the following terms and conditions: 1) that the defendant corporation promptly and fully pay the victim restitution below ordered as part of this sentence, 2) that the defendant corporation promptly and fully perform its obligations to clean up the land where it previously conducted business to meet the standards of the U.S. Environmental Protection Agency and the Colorado Department of Health, and 3) that the defendant corporation fully cooperate with the Probation Department and perform all terms and conditions of the probation imposed by this court, including payment of restitution.

Count V.

It is ordered as to Count V that the defendant corporation pay a fine of \$10,000.00 to the United States. Execution of that fine is suspended and the defendant corporation is placed on probation for a period of five years, on the following terms and conditions: 1) that the defendant corporation promptly and fully pay the victim restitution below ordered as part of this sentence, 2) that the defendant corporation promptly and fully perform its obligations to clean up the land where it previously conducted business to meet the standards of the U.S. Environmental Protection Agency and the Colorado Department of Health, and 3) that the defendant corporation fully cooperate with the Probation Department and perform all terms and conditions of the probation imposed by this court, including payment of restitution. The defendant corporation immediately shall pay \$200.00 to the Crime Victim Fund

pursuant to Title 18 U.S.C. § 3013.

Count VI.

It is ordered as to Count VI that the defendant corporation pay a fine of \$500,000.00 to the United States. The execution of all but \$60,000.00 of that fine is suspended and the defendant corporation is placed on probation for a period of five years, on the following terms and conditions: 1) that the defendant corporation promptly and fully pay the victim restitution below ordered as part of this sentence, 2) that the defendant corporation promptly and fully perform its obligations to clean up the land where it previously conducted business to meet the standards of the U.S. Environmental Protection Agency and the Colorado Department of Health, and 3) that the defendant corporation fully cooperate with the Probation Department and perform all terms and conditions of the probation imposed by this court, including payment of restitution. The defendant corporation immediately shall pay \$200.00 to the Crime Victim Fund pursuant to Title 18 U.S.C. § 3013.

Count VII.

It is ordered as to Count VII that the defendant corporation pay a fine of \$500,000.00 to the United States. The execution of all but \$30,000.00 of that fine is suspended and the defendant corporation is placed on probation for a period of five years, on the following terms and conditions: 1) that the defendant corporation promptly and fully pay the victim restitution below ordered as part of this sentence, 2) that the defendant corporation promptly and fully perform its obligations to clean up the land where it previously conducted business to meet the standards of the U.S. Environmental Protection Agency and the Colorado Department of Health, and 3) that the defendant corporation fully cooperate with the Probation Department and perform all

terms and conditions of the probation imposed by this court, including payment of restitution. The defendant corporation immediately shall pay \$200.00 to the Crime Victim Fund pursuant to Title 18 U.S.C. § 3013.

Count VIII.

It is ordered as to Count VIII that the defendant corporation pay a fine of \$500,000.00 to the United States. The execution of all but \$30,000.00 of that fine is suspended and the defendant corporation is placed on probation for a period of five years, on the following terms and conditions: 1) that the defendant corporation promptly and fully pay the victim restitution below ordered as part of this sentence, 2) that the defendant corporation promptly and fully perform its obligations to clean up the land where it previously conducted business to meet the standards of the U.S. Environmental Protection Agency and the Colorado Department of Health, and 3) that the defendant corporation fully cooperate with the Probation Department and perform all terms and conditions of the probation imposed by this court, including payment of restitution. The defendant corporation immediately shall pay \$200.00 to the Crime Victim Fund pursuant to Title 18 U.S.C. § 3013.

Count IX.

It is ordered as to Count IX that the defendant corporation pay a fine of \$500,000.00 to the United States. The execution of all but \$30,000.00 of that fine is suspended and the defendant corporation is placed on probation for a period of five years, on the following terms and conditions: 1) that the defendant corporation promptly and fully pay the victim restitution below ordered as part of this sentence, 2) that the defendant corporation promptly and fully perform its obligations to clean up the land where it previously conducted business to meet the standards of the U.S. Environmental Protection

Agency and the Colorado Department of Health, and 3) that the defendant corporation fully cooperate with the Probation Department and perform all terms and conditions of the probation imposed by this court, including payment of restitution. The defendant corporation immediately shall pay \$200.00 to the Crime Victim Fund pursuant to Title 18 U.S.C. § 3013.

Count XII.

It is ordered as to Count XII that the defendant corporation pay a fine of \$500,000.00 to the United States. The execution of all but \$30,000.00 of that fine is suspended and the defendant corporation is placed on probation for a period of five years, on the following terms and conditions: 1) that the defendant corporation promptly and fully pay the victim restitution below ordered as part of this sentence, 2) that the defendant corporation promptly and fully perform its obligations to clean up the land where it previously conducted business to meet the standards of the U.S. Environmental Protection Agency and the Colorado Department of Health, and 3) that the defendant corporation fully cooperate with the Probation Department and perform all terms and conditions of the probation imposed by this court, including payment of restitution. The defendant corporation immediately shall pay \$200.00 to the Crime Victim Fund pursuant to Title 18 U.S.C. § 3013.

Count XIII.

It is ordered as to Count XIII that the defendant corporation pay a fine of \$500,000.00 to the United States. The execution of all but \$30,000.00 of that fine is suspended and the defendant corporation is placed on probation for a period of five years, on the following terms and conditions: 1) that the defendant corporation promptly and fully pay the victim restitution below ordered as part of this sentence, 2) that the defendant corporation promptly

and fully perform its obligations to clean up the land where it previously conducted business to meet the standards of the U.S. Environmental Protection Agency and the Colorado Department of Health, and 3) that the defendant corporation fully cooperate with the Probation Department and perform all terms and conditions of the probation imposed by this court, including payment of restitution. The defendant corporation immediately shall pay \$200.00 to the Crime Victim Fund pursuant to Title 18 U.S.C. § 3013.

Count XIV.

It is ordered as to Count XIV that the defendant corporation pay a fine of \$500,000.00 to the United States. The execution of all but \$30,000.00 of that fine is suspended and the defendant corporation is placed on probation for a period of five years, on the following terms and conditions: 1) that the defendant corporation promptly and fully pay the victim restitution below ordered as part of this sentence, 2) that the defendant corporation promptly and fully perform its obligations to clean up the land where it previously conducted business to meet the standards of the U.S. Environmental Protection Agency and the Colorado Department of Health, and 3) that the defendant corporation fully cooperate with the Probation Department and perform all terms and conditions of the probation imposed by this court, including payment of restitution. The defendant corporation immediately shall pay \$200.00 to the Crime Victim Fund pursuant to Title 18 U.S.C. § 3013.

Count XV.

It is ordered as to Count XV that the defendant corporation pay a fine of \$100,000.00 to the United States. The execution of all but \$30,000.00 of that fine is suspended and the defendant corporation is placed on probation for a period of five years, on the following terms and conditions: 1) that

the defendant corporation promptly and fully pay the victim restitution below ordered as part of this sentence, 2) that the defendant corporation promptly and fully perform its obligations to clean up the land where it previously conducted business to meet the standards of the U.S. Environmental Protection Agency and the Colorado Department of Health, and 3) that the defendant corporation fully cooperate with the Probation Department and perform all terms and conditions of the probation imposed by this court, including payment of restitution. The defendant corporation immediately shall pay \$100.00 to the Crime Victim Fund pursuant to Title 18 U.S.C. § 3013.

Count XVI.

It is ordered as to Count XVI that the defendant corporation pay a fine of \$500,000.00 to the United States. The execution of all but \$30,000.00 of that fine is suspended and the defendant corporation is placed on probation for a period of five years, on the following terms and conditions: 1) that the defendant corporation promptly and fully pay the victim restitution below ordered as part of this sentence, 2) that the defendant corporation promptly and fully perform its obligations to clean up the land where it previously conducted business to meet the standards of the U.S. Environmental Protection Agency and the Colorado Department of Health, and 3) that the defendant corporation fully cooperate with the Probation Department and perform all terms and conditions of the probation imposed by this court, including payment of restitution. The defendant corporation immediately shall pay \$200.00 to the Crime Victim Fund pursuant to Title 18 U.S.C. § 3013.

Count XVII.

It is ordered as to Count XVII that the defendant corporation pay a fine of \$1,000,000.00 to the United States. The execution of all but

\$30,000.00 of that fine is suspended and the defendant corporation is placed on probation for a period of five years, on the following terms and conditions: 1) that the defendant corporation promptly and fully pay the victim restitution below ordered as part of this sentence, 2) that the defendant corporation promptly and fully perform its obligations to clean up the land where it previously conducted business to meet the standards of the U.S. Environmental Protection Agency and the Colorado Department of Health, and 3) that the defendant corporation fully cooperate with the Probation Department and perform all terms and conditions of the probation imposed by this court, including payment of restitution. The defendant corporation immediately shall pay \$200.00 to the Crime Victim Fund pursuant to Title 18 U.S.C. § 3013.

Count XVIII.

It is ordered as to Count XVIII that the defendant corporation pay a fine of \$1,000,000.00 to the United States. The execution of all but \$30,000.00 of that fine is suspended and the defendant corporation is placed on probation for a period of five years, on the following terms and conditions: 1) that the defendant corporation promptly and fully pay the victim restitution below ordered as part of this sentence, 2) that the defendant corporation promptly and fully perform its obligations to clean up the land where it previously conducted business to meet the standards of the U.S. Environmental Protection Agency and the Colorado Department of Health, and 3) that the defendant corporation fully cooperate with the Probation Department and perform all terms and conditions of the probation imposed by this court, including payment of restitution. The defendant corporation immediately shall pay \$200.00 to the Crime Victim Fund pursuant to Title 18 U.S.C. § 3013.

Count XIX.

It is ordered as to Count XIX that the defendant corporation pay

a fine of \$1,000,000.00 to the United States. The execution of all but \$30,000.00 of that fine is suspended and the defendant corporation is placed on probation for a period of five years, on the following terms and conditions: 1) that the defendant corporation promptly and fully pay the victim restitution below ordered as part of this sentence, 2) that the defendant corporation promptly and fully perform its obligations to clean up the land where it previously conducted business to meet the standards of the U.S. Environmental Protection Agency and the Colorado Department of Health, and 3) that the defendant corporation fully cooperate with the Probation Department and perform all terms and conditions of the probation imposed by this court, including payment of restitution. The defendant corporation immediately shall pay \$200.00 to the Crime Victim Fund pursuant to Title 18 U.S.C. § 3013.

Pursuant to Title 18 U.S.C. § 3651, upon the evidence heard at trial and received in the sentencing hearing, the court finds that Terry Baumgartner, Richard Tice and Robert Evans are victims of the offenses charged in Counts XVII, XVIII and XIX, respectively, and have been damaged in the respective amounts herein awarded them as restitution. It is ordered that the defendant corporation shall make restitution in the respective amounts of \$350,000.00 to Terry Baumgartner, \$325,000.00 to Richard Tice and \$275,000.00 to Robert Evans. These amounts shall be deposited in interest bearing accounts at the National Bank of the Rockies, Denver, Colorado, within ten days. There shall be three separate trust accounts as outlined and offered to the court.

Until further order of the court, Lee Foreman and Hal Haddon of the law firm of Haddon, Morgan and Foreman shall serve as temporary co-trustees for the account of Terry Baumgartner, and Adam Babich and Kent Hanson shall serve as temporary co-trustees for Robert Evans and Richard Tice. Trust

agreements shall be drafted and signed to protect the victims and assure safe investment of their restitution funds. Counsel shall submit proposed trust agreements to the court within ten days.

It is further ordered that the fines on Counts I, VI, VII, VIII, IX, XII, XIII, XIV, XV, XVI, XVII, XVIII and XIX are to be paid to the U.S. Treasury through the U.S. Attorney's Office. The fines on Counts II, III and V are to be paid to the Clerk of the Court, U.S. District Court, Denver, Colorado.

It is further ordered that no attorneys' fees shall be paid out of the restitution except by order of this court.

It is further ordered that the proceeds from the sale of Protex Industries, Inc. may now be used to pay the fines imposed and the restitution to the victims Terry Baumgartner, Richard Tice and Robert Evans. It is ordered that these funds not be used to pay for clean-up on the land previously used by the defendant in its business until after the payment of the fines and restitution, for the reason that the clean-up will merely enhance the value of the land to the benefit of its owners who are the controlling owners of the defendant Protex, or family members of the controlling owners. I find and conclude that it would be unjust to allow the fines and restitution to be defeated by using the corporation's limited funds to enhance the value of the land to the benefit of those who owned and controlled the defendant corporation when its crimes were being committed.

No attorneys' fees are to be paid out of these corporate assets without written order of this court. No other payments shall be made from the defendant

corporation's funds without written order of this court.

Dated at Denver, Colorado, March 24, 1988, nunc pro tunc March 4, 1988.

BY THE COURT:

Jim R. Carrigan
JIM R. CARRIGAN, JUDGE
UNITED STATES DISTRICT COURT

ENTERED
ON THE DOCKET

MAR 24 1988

JAMES R. MANSPEAKER
CLERK

JRM

I, the undersigned, Clerk of the United States District Court for the District of Colorado, do certify that the foregoing is a true copy of an original document existing on file and recorded in the office of said

WITNESSED my hand and the seal of said Court at Denver, Colorado, this 24th day of March 1988.
James R. Manspeaker
Clerk

CERTIFIED TRUE COPY
ATTEST: DEBORAH GREEN
Clerk, U.S. District Court
Western District of Washington

By

[Handwritten signature]

Deputy Clerk
FILED
LODGED
ENTERED
RECEIVED

Judge Voorhees

MAY 2 1985

AT SEATTLE
CLERK U.S. DISTRICT COURT
WESTERN DISTRICT OF WASHINGTON
BY *[Handwritten initials]* DEPUTY

FILED
LODGED
ENTERED
RECEIVED

APR 30 1985

AT SEATTLE
CLERK U.S. DISTRICT COURT
WESTERN DISTRICT OF WASHINGTON

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF WASHINGTON
AT SEATTLE

UNITED STATES OF AMERICA,)
)
 Plaintiff,)
)
 v.)
)
 THE WYCKOFF COMPANY, INC.,)
)
 Defendant.)

NO. CR84-167V

JUDGMENT AND ORDER
OF PROBATION

On this 19th day of April, 1985, came the attorney for the Government and a representative for defendant Wyckoff Company, Inc., its President, William C. Cairns, with counsel, Charles S. Mullen and Frederick O. Frederickson.

This Court having accepted the terms of the Plea Agreement between the United States and defendant Wyckoff Company, Inc., pursuant to Rule 11(e)(1)(C), Federal Rules of Criminal Procedure,

IT IS THEREFORE ADJUDGED, upon defendant's pleas of GUILTY to Counts II and IV of the Information, and the Court being satisfied there is a factual basis for each plea, the Wyckoff Company, Inc., has been convicted of the offense of violation of Title 42, United States Code, Section 6928(d)(2)(A), knowing

172

(85-3-85)

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26

1 storage during the period from on or about November 20, 1980, and
2 continuing until a date not later than May 27, 1983, of hazardous
3 waste (that is, bottom sediment sludge from the treatment of
4 waste waters from wood preserving processes that used creosote
5 and pentachlorophenol) in an unlined, partially timbered earthen
6 pit, without having obtained a permit for said storage from the
7 Administrator of the United States Environmental Protection
8 Agency, as charged in Count II of the Information; and has
9 further been convicted of the offense of violation of Title 33,
10 United States Code, Sections 1311(a) and 1319(c)(1), willful and
11 negligent discharge of pollutants (that is, waters containing
12 wood preserving residues) from a point source into a navigable
13 water of the United States, without having first obtained a
14 permit for such discharge under the National Pollutant Discharge
15 Elimination System, as charged in Count IV of the Information,
16 and the Court having asked defendant's representatives whether
17 they have anything to say on its behalf concerning why judgment
18 should not be pronounced, and no sufficient cause to the contrary
19 being shown or appearing to the Court,

20 IT IS ADJUDGED that the defendant is guilty as charged and
21 convicted of the offenses set forth in Counts II and IV of the
22 Information.

23 IT IS ADJUDGED that the defendant Wyckoff Company, Inc., pay
24 a fine to the United States in the sum of ONE MILLION DOLLARS
25 (\$1,000,000.00) as to Count II, and a fine in the sum of
26

1 ONE HUNDRED FIFTY THOUSAND DOLLARS (\$150,000.00) as to Count IV,
2 to be imposed concurrently on the two counts, for a total fine of
3 ONE MILLION DOLLARS (\$1,000,000.00), with the execution of all
4 but One Hundred Fifty Thousand Dollars (\$150,000.00) of such fine
5 suspended, and defendant Wyckoff placed upon probation for five
6 years upon the following terms and conditions:

7 a. Wyckoff shall comply with all federal, state, and
8 local laws, including those related to environmental matters;

9 b. Wyckoff shall comply with the rules and
10 regulations of the United States Department of Probation;

11 c. Wyckoff shall take all reasonable steps to
12 eliminate the release of pollutants, contaminants and hazardous
13 substances from its West Seattle property, if any, as
14 expeditiously as possible.

15 d. Wyckoff shall pay the sum of One Hundred Fifty
16 Thousand Dollars (\$150,000.00) as a fine payable to the Treasurer
17 of the United States on or before April 29, 1985;

18 e. Wyckoff shall establish on or before April 29,
19 1985, an Environmental Trust Fund, as approved by the
20 United States Department of Probation, with an appropriate
21 financial institution, for the benefit of the United States for
22 the purpose of providing funds for the clean-up of Puget Sound or
23 the Duwamish River or contaminated soil or groundwater nearby
24 those waterbodies; for conducting monitoring or studies on or
25 near defendant's properties in the Puget Sound area to determine
26 the need for, or appropriate extent of, any such clean-up

1 efforts; or for planning and constructing facilities on or near
2 defendant's properties in the Puget Sound area to prevent the
3 release to the environment from such properties any pollutants,
4 contaminants, or hazardous substances, if any. Payments to this
5 Trust Fund shall not be considered to be payments of a fine or
6 penalty. Defendant shall make the following payments into that
7 Environmental Trust Fund:

- 8 1. \$100,000.00 within 10 days of entry of this
9 judgment;
- 10 2. \$100,000.00 within 90 days of entry of this
11 judgment;
- 12 3. \$100,000.00 within 180 days of entry of this
13 judgment;
- 14 4. \$110,000.00 within 1 year of entry of this
15 judgment;
- 16 5. \$110,000.00 within 2 years of entry of this
17 judgment;
- 18 6. \$110,000.00 within 3 years of entry of this
19 judgment;
- 20 7. \$110,000.00 within 4 years of entry of this
21 judgment;
- 22 8. \$110,000.00 within 4 and 1/2 years of
23 entry of this judgment.

24 The defendant may accelerate these payments at its option.

25 f. The above payments into said Environmental Trust
26 Fund, listed in subsections 2 through 8 of the preceding section,
shall be secured by a "clean" or unconditional letter of credit
totaling Seven Hundred Fifty Thousand Dollars (\$750,000.00) from
an appropriate financial institution, with the approval of the

1 Probation Department, said letter of credit to be obtained and
2 secured by the Company on or before the tenth day following entry
3 of judgment. The payee of said letter of credit shall be the
4 Environmental Trust Fund, upon demand and direction by the
5 United States following (and if) there is a failure by the
6 Wyckoff Company to make any payment listed in subsections 2
7 through 8, above. "Unconditional" as used herein means subject
8 only to the demand and direction of the United States as set
9 forth above. The dollar amount of the letter of credit shall be
10 reduced by the amount of each of defendant's deposits.

11 g. The Environmental Trust Fund terms of trust shall
12 establish that the Fund is an irrevocable inter-vivos trust with
13 said financial institution as trustee (the Trustee). The terms
14 of trust shall grant the Environmental Protection Agency
15 Region 10 Administrator, and any successor Administrator, an
16 irrevocable, general power of appointment over Fund income and
17 corpus, to be exercisable by signed letter to the Trustee. The
18 Administrator shall exercise its general power of appointment
19 consistent with paragraphs h, i, and j below.

20 h. The first \$300,000.00 from the Trust Fund shall be
21 applied to efforts by either defendant or the United States
22 Environmental Protection Agency ("EPA"), pursuant to Section 3013
23 of the Resource Conservation and Recovery Act, to determine the
24 extent to which hazardous waste and hazardous waste constituents
25 are present at or have been released from defendant's West
26

1 Seattle and Eagle Harbor properties; if all \$300,000.00 is not
2 needed for that purpose, the remainder shall be left in the trust
3 for other purposes consistent therewith; and if more than
4 \$300,000.00 is needed to do the Section 3013 determinations, the
5 excess funds must come from a source other than the trust unless
6 the Court directs otherwise.

7 i. The remaining \$550,000.00 from the Trust Fund
8 shall be applied first, to a project or projects necessary or
9 appropriate to prevent the future release to the environment from
10 defendant's properties of any pollutants, contaminants or
11 hazardous substances; second, to the clean-up of contaminated
12 soil or groundwater at or adjacent to defendant's West Seattle or
13 Eagle Harbor properties; third, to the clean-up of the Duwamish
14 River or Puget Sound or in the general vicinity of defendant's
15 properties; or fourth, to such other projects designated by the
16 court. Expenditures made, or that will be made, by defendant for
17 development or construction of the pretreatment system for heavy
18 metals and other contaminants, for which permit application has
19 already been submitted to the Municipality of Metropolitan
20 Seattle (METRO), shall not qualify for payments from, or credit
21 to, the Trust Fund.

22 j. Defendant shall submit nominations to the
23 Administrator of Region 10 of the EPA for pollution-control or
24 clean-up projects within the scope of paragraph i. above. The
25 Administrator shall either approve or disapprove the projects and
26 expenditures relating thereto in light of the purposes of the

1 Trust Fund. All approved expenditures shall be paid from the
2 Trust Fund by the trustee, at the direction of the Administrator,
3 or may be credited to defendant's Trust Fund obligations.

4 k. Should probation be revoked or all the trust funds
5 not expended at the time probation is otherwise concluded, all
6 funds remaining in the Trust Fund at that time may be dedicated
7 by the Administrator, for purposes consistent with the original
8 trust purposes.

9 1. Nothing in the terms of such a probationary
10 sentence shall diminish defendant's legal obligations, if any, to
11 make expenditures or take actions under any local, state or
12 federal laws in addition to the expenditures made within the
13 terms of the Trust Fund contemplated herein.

14 IT IS FURTHER ORDERED that the Clerk deliver three certified
15 copies of this Judgment and Order to the Probation Officer of
16 this Court, one of which shall be delivered to the defendant by
17 the Probation Officer.

18 Donald S. Brown
19 UNITED STATES DISTRICT JUDGE

20 _____ Clerk.

21 Presented by:
22 David V. Marshall
23 DAVID V. MARSHALL
Assistant United States Attorney

24 Approved as to form:
25 Charles S. Mullen
26 CHARLES S. MULLEN
FREDERICK O. FREDERICKSON
Attorneys for Defendant



UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
WASHINGTON, D.C. 20460

NOV 14 1988

OFFICE OF
ENFORCEMENT AND
COMPLIANCE MONITORING

MEMORANDUM

SUBJECT: Post-Sentence Followup
United States v. XYZ Corporation (N.D. NY)

FROM: Bruce G. Bellin 
Senior Counsel
Office of Criminal Enforcement Counsel

TO: John H. Jones
Deputy Regional Administrator
Region X

The XYZ Corporation (XYZ) has been found guilty of criminal knowing violations of the Resource Conservation and Recovery Act. As part of the sentence for that guilty verdict, XYZ has agreed to be placed on three years probation from August 1988 though August 1991. A copy of the defendant's probation agreement is attached for your information.

As a condition of that probation, XYZ has agreed to comply with all federal, state, and local laws, which include all federal and state environmental laws. Please advise your program offices and environmental enforcement authorities of States in which XYZ facilities are located of XYZ's probationary status so that those offices can monitor, as appropriate, XYZ's environmental compliance.

If environmental violations by XYZ occur during the term of its probation, please promptly notify the Regional Criminal Enforcement Counsel and the Office of Criminal Investigations' Special Agent-in-Charge in your Region so that enforcement options, as warranted, can be considered by the Office of Probation. My number is FTS 475-9660 if there are questions about this matter.

cc: Frank Smith, SAIC
Bryce Henry, Regional Criminal Enforcement Counsel



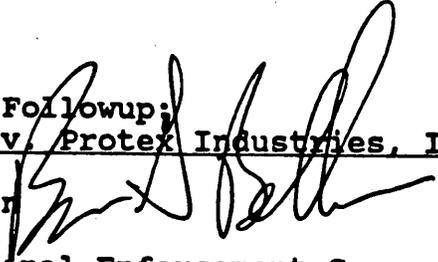
UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
WASHINGTON, D.C. 20460

APR 28 1988

OFFICE OF
ENFORCEMENT AND
COMPLIANCE MONITORING

MEMORANDUM

SUBJECT: Post-Sentence Followup;
United States v. Protex Industries, Inc.

FROM: Bruce G. Bellin 
Senior Counsel
Office of Criminal Enforcement Counsel

TO: Alexandra B. Smith
Deputy Regional Administrator
Region VIII

Protex Industries, Inc. has been found guilty of criminal knowing violations of the Resource Conservation and Recovery Act. As part of the sentence for that guilty verdict, Protex Industries, Inc. has agreed to be placed on five (5) years probation from March 1988 through February 1993. A copy of the defendant's Judgment and Sentencing Order is attached for your information.

As a condition of that probation, Protex Industries, Inc. has agreed to comply with all federal, state and local laws, which include all federal and state environmental laws. Please advise your program offices and environmental enforcement authorities of the states in which Protex Industries, Inc. facilities are located of Protex's probationary status so that those offices can monitor, as appropriate, Protex's environmental compliance.

If environmental violations by Protex Industries, Inc. occur during the term of its probation, please promptly notify the Criminal Contact Attorney and the Office of Criminal Investigation's Special Agent-in-Charge in your Region so that enforcement options, as warranted, can be considered by the Office of Probation. My number is FTS 475-9660 if there are questions about this matter.

cc: John W. West, SAC
Michael T. Risner, Criminal Contact Attorney



Ivan P.L. P'ng
Eric M. Zolt

SCHOOL OF LAW
405 HILGARD AVENUE
LOS ANGELES, CALIFORNIA 90024-1476

TESTIMONY BEFORE THE U.S. SENTENCING COMMISSION
December 2, 1988

I. Introduction

Thank you for allowing us to appear here today. My name is Eric Zolt and I am here with Ivan P'ng. I am a tax professor at UCLA School of Law, Mr. P'ng is a professor of Business Economics at the UCLA Graduate School of Management.

Our contribution to your hearing is relatively simple and straightforward. We believe that any rational scheme of deterrence must consider the income tax consequences of the sanctions. Our testimony today is based on our article "Fines for Business Offenses: Optimal Enforcement in the Presence of Income Taxation."

II. Guidelines for Monetary Sanctions

The draft sentencing guidelines for organizational defendants rely primarily on monetary sanctions. Monetary sanctions are a function of three factors: (i) the "offense loss," based on the total harm caused by the offense; multiplied by (ii) the "offense multiple," based on the difficulty of detecting and punishing the offender; plus (iii) enforcement costs. The guidelines do not consider tax consequences.

III. Current Tax Treatment of Monetary Sanctions

The tax law does not treat monetary sanctions imposed on organizational defendants in a coherent fashion. Congress disallows deductions for amounts paid for fines or similar penalties, for bribes and kickbacks, and for the punitive portion of certain antitrust violations. Deductions are generally allowed, however, for damages paid, even as a result of fraud, and for those penalties that are compensatory.

IV. Focus of Testimony

While our paper adopts the "harm-based" deterrence approach in the analysis of tax considerations, we believe failure to consider the tax consequences of sanctions is a deficiency common to all deterrence schemes discussed today. Tax consequences have not been considered in the optimal deterrence literature upon which much of the testimony before you today derives or included in any of the reports prepared by the Sentencing Commission staff. Tax consequences will either magnify or diminish the effect of the sanctions. We believe that failure to consider such consequences results in a deterrence scheme that is both inefficient and inequitable. Such scheme is inefficient because it interferes with the firm's efficient use of inputs. It is inequitable because it treats offenders differently depending on their respective tax positions and whether the tax system allows a deduction for amounts paid as sanctions.

V. Efficiency

The potential inefficiency from the guidelines' failure to consider tax consequences may be illustrated with a simple example. We adopt as a benchmark the socially efficient mix of inputs -- whether or not such inputs give rise to external harm. Suppose an oil refinery can choose between two inputs: (i) an input of labor that costs \$100, and (ii) an input that costs \$50 and generates pollution that causes harms to others of \$40, for a total of \$90. From the standpoint of social efficiency, the firm should choose the lowest cost input -- the input that generates the pollution.

Now assume there are no problems of detection or costs of enforcement. Following the draft guidelines, the proper sanction imposed on the firm using the input causing the pollution would be \$40, the amount of the harm caused. If the oil refinery pays tax at a marginal rate of 34%, then the after-tax cost of the input of labor would be \$66 (\$100 input cost - \$34 tax benefit). If the monetary sanction is nondeductible, then the after-tax cost of the input generating the pollution is \$73 ((\$50 input cost - \$17 tax benefit] + \$40 sanction). The firm would thus choose the socially inefficient input. This results in higher costs of production and inefficient use of resources.

VI. Inequity

While the draft guidelines purport to reject the use of the organization's size or financial performance as a measure of sanctions, this may not be true. Disallowing tax deductions for amounts paid as sanctions increases the amount of the penalty. Those offenders with higher marginal tax rates bear greater costs from the disallowance than those offenders in

lower tax brackets. No or little additional costs are imposed on offenders who are either exempt from taxation (such as tax-exempt hospitals and universities) or have substantial net operating losses. No apparent justification exists for this disparate treatment.

Failure to consider tax consequences also results in different treatment for different offenses. The current tax system provides for deductibility for amounts paid for some sanctions, but not for others. While the draft guidelines may present a coherent treatment of monetary sanctions on a before-tax basis, the after-tax results will likely be quite different.

VII. Recommendations

We recommend that the sentencing guidelines for organizational defendants consider the tax consequences of the monetary sanctions. Two alternatives are available. The first approach is to coordinate with Congress to allow for full tax deductibility for monetary sanctions and set such sanctions in accordance with your guidelines. The alternative approach for those sanctions that are not deductible is to adjust the amount of the monetary sanction to reflect the marginal tax rate of the offender. If the offender bears a marginal tax rate of 34%, then the monetary sanction should be multiplied by a factor of .66 (1 - tax rate). For the earlier example, the amount of the sanction should be adjusted to \$26.40.

We believe that either of these approaches improves the efficient use of resources and results in more equitable treatment of potential offenders.

IVAN PAAK-LIANG PNG

John E. Anderson Graduate School of Management
University of California
405 Hilgard Avenue
Los Angeles, CA 90024-1481

(213) 825-9169

Research and Teaching Interests

Industrial Organization, Law and Economics, Distribution and Pricing Strategy

Employment

1984-present UNIVERSITY OF CALIFORNIA, LOS ANGELES, JOHN E. ANDERSON
GRADUATE SCHOOL OF MANAGEMENT
Assistant Professor of Business Economics

1987-1988 NATIONAL UNIVERSITY OF SINGAPORE, SCHOOL OF MANAGEMENT
Lecturer

Summer 1982 GOVERNMENT OF SINGAPORE INVESTMENT CORPORATION
Special Assistant to the Managing Director

1978-80 MINISTRY OF DEFENCE, REPUBLIC OF SINGAPORE
Battalion Deputy General Staff Officer, then Brigade Deputy
Intelligence Officer

Education

1980-85 STANFORD UNIVERSITY, GRADUATE SCHOOL OF BUSINESS
Ph.D. in Economics, Business and Public Policy.

1975-78 UNIVERSITY OF CAMBRIDGE
BA (Honours Class 1) in Economics

Awards Research Grants, Academic Senate, UCLA (1985, 1986, 1987,
1988)
Chancellor's Career Development Award, UCLA (1987)

Publications

"Strategic Behavior in Suit, Settlement and Trial", Bell
Journal of Economics, Vol. 14 (Autumn 1983), pp. 539--550.

"Optimal Subsidies and Damages in the Presence of Judicial
Error", International Review of Law and Economics, Vol. 6
(June 1986), pp. 101--105.

"Price Discrimination Through Offers to Match Price", Journal
of Business, Vol. 60 (July 1987), pp. 365--384 [with D.
Hirshleifer].

"Liability Rules, Litigation, and Incentives for Care",
Journal of Public Economics, Vol. 34 (October 1987), pp. 61--
85.

Working Papers "Sex, Race, and Grades: Empirical Evidence of Discrimination in Law Firm Interviews", Revised, September 1988 [with D. Eaves & M. Ramseyer].

"Reservations: Customer Insurance in the Marketing of Capacity", Revised, October 1988.

"Optimal Auditing, Insurance and Redistribution", Revised, November 1988 [with D. Mookherjee].

"Optimal Deterrence in the Presence of Income Taxation", Revised, November 1988 [with E. Zolt].

"Pricing by Likelihood of Availability Without Precommitment", Revised, November 1988.

Opinion "Auction Long-Distance Service for the Undecided", Wall Street Journal, May 29, 1985

"Frequent Flyer Plans: Marketing Device With Insidious Effects", Los Angeles Times, June 22, 1986

"Minimum Wage, Maximum Controversy", Los Angeles Times, January 10, 1988.

Professional Reviewer, Rand Journal of Economics, American Economic Service Review, Management Science, Review of Economic Studies, Review of Financial Studies, Journal of Political Economy, Quarterly Journal of Economics, International Review of Law and Economics, Econometrica, Asia-Pacific Journal of Management, Journal of Public Economics, Journal of Business, and Journal of Law, Economics, and Organization.

ERIC M. ZOLT

UCLA School of Law
Los Angeles, CA 90024
(213) 206-0394

Professional
Experience

- 7/85 - Present Acting Professor of Law, UCLA School of Law

Research and teaching interests in corporate and individual federal income taxation.

UCLA Law School Professor of the Year, 1987
- 3/81 - 6/85 Tax Attorney, Kirkland & Ellis, Chicago, Illinois

Associate from March 1981 and Partner from June 1984.
- 6/78 - 2/81 Corporate and Tax Attorney, Schiff Hardin & Waite, Chicago, Illinois
- 1/84 - 6/84 Part-time Faculty, Corporate Taxation, Loyola University of Chicago School of Law
- 6/76 - 7/77 Research Staff, Center for Policy Alternatives, Massachusetts Institute of Technology

Economic and legal analysis in several areas of government intervention and regulation.

Professional
Licenses

- Certified Public Accountant, Illinois, August 1976

Admitted to Illinois Bar, November 1978

Education

- The Law School University of Chicago

Received J.D. in June 1978. Associate Editor, University of Chicago Law Review.
- Graduate School of Business University of Chicago

Received M.B.A. in June 1975.
- The Wharton School University of Pennsylvania

Received B.S. in Economics in May 1974.

Partial Listing of Reports, Publications and Speeches

Economic/Social Impact of Occupational Noise Exposure Regulations, September 1976. This report was presented at the OSHA hearings on the Economic Impact of Occupational Noise Exposure Regulations, September 30, 1976 and published as EPA Report No. 550/9-77-352. Co-authors: N. Ashford, D. Hattis, G. Heaton and J. Katz.

Comment on Drug Regulation and Innovation in the Pharmaceutical Industry, January 1977. This report was presented to the HEW Review Panel on New Drug Regulation and was incorporated in the Panel's report to former Secretary Califano in March 1977. Co-authors: N. Ashford and S. Butler.

Evaluating Chemical Regulations: Trade-off Analysis and Impact Assessment for Environmental Decision-making, March 1979. This report was prepared for the Council on Environmental Quality and the Environmental Protection Agency. Co-authors: N. Ashford, D. Hattis and J. Katz.

Comment, An Economic Perspective on the Law of Excessive Profits Recovery, 45 U.Chl.L.Rev. 882 (1978). Co-author: J. Berkowitz.

The Tax Consequences of the Recharacterization of an Economic Relationship as a Partnership for Federal Income Tax Purposes, 32 Taxation for Accountants 232 (1984). Co-author: J. Ruppert.

Evaluating Real Estate Tax Shelters, September 1984 and October 1985. This outline was presented at seminars sponsored by the Real Estate Tax Institute on Advanced Tax Planning for Real Estate Transactions in Chicago in September 1984 and in Los Angeles in October 1985.

Alternative Structures for Raising Capital for Research and Development, May 1985. This outline was presented at a seminar sponsored by the Illinois Institute for Continuing Legal Education on Raising Venture Capital through R&D Limited Partnerships after the Tax Reform Act of 1984. Co-author: J. Levin.

The General Utilities Doctrine: Examining the Scope of the Repeal, 65 Taxes 819 (1987). The article was presented at the University of Chicago Law School's Annual Federal Tax Conference in October 1987.

Corporate Taxation After the Tax Reform Act of 1986: A State of Disequilibrium. 66 N.C.L. Rev. 839 (1988).

Fines for Business Offenses: Optimal Deterrence in the Presence of Income Taxation. Business Economics Working Paper #88-13, John E. Anderson Graduate School of Management, UCLA. Co-author: I.P.L. P'ng.

Deterrence via Taxation: A Critical Analysis of Tax Penalty Provisions. (in progress).

THE JOHN E. ANDERSON GRADUATE
SCHOOL OF MANAGEMENT AT UCLA

Business Economics
Working Paper # 88-13

**Fines for Business Offenses: Optimal Enforcement
in The Presence of Income Taxation**

by

Ivan P'ng
and
Eric M. Zolt

August 30, 1988

UCLA gratefully acknowledges the support of the Olin Foundation for this series



December 2, 1988

**FINES FOR BUSINESS OFFENSES: OPTIMAL ENFORCEMENT
IN THE PRESENCE OF INCOME TAXATION**

Ivan P'ng¹ and Eric M. Zolt²

Some socially useful activities generate external harm. Oil refineries and furniture manufacturers generate air and water pollution, overloaded trucks damage highways, overnight delivery services block traffic as they double park, and improperly maintained airplanes present safety problems. These results are undesirable and, at some cost, preventable. To control these external harms, the government³ imposes restrictions. To enforce these restrictions, the government often subjects offenders to fines and penalties.⁴

There is no general agreement about whether the government does or should set the amount of fines or penalties based on

¹ Assistant Professor, John E. Anderson Graduate School of Management, University of California, Los Angeles.

² Acting Professor, University of California, Los Angeles School of Law.

³ For convenience, we refer to United States institutions; the implications of this analysis, however, apply generally to other countries with similar laws. The term "government" as used herein includes local, state and federal governments and their administrative agencies.

⁴ See Goldschmid, An Evaluation of the Present and Potential Use of Civil Money Penalties as a Sanction by Federal Administrative Agencies, in 2 Recommendations and Reports of the Administrative Conference of the United States 896 (1972); Diver, The Assessment and Mitigation of Civil Money Penalties by Federal Administrative Agencies, 79 Colum. L. Rev. 1435 (1979) (describing the use of fines and penalties by federal administrative agencies).

estimates of the external harm caused, or merely as an expensive reminder to comply with the rule or standard. Uncertainty also exists about whether the government considers tax consequences in designing fines and penalties. This Article, like prior work in the optimal fine literature,⁵ argues for the government to consider explicitly external harm in setting fines and penalties. We further demonstrate that the government must also consider tax consequences in designing fines and penalties.

The tax system distorts regulation because taxpayers generally cannot deduct for federal income tax purposes amounts paid as fines or similar penalties.⁶ We examine the economic consequences of disallowing tax deductions for amounts paid as fines or penalties by demonstrating the effect of the disallowance on a firm's efficient use of inputs.⁷ We take narrow aim. First, we focus on socially useful activities that

⁵ See, e.g., Becker, *Crime and Punishment: An Economic Approach*, 76 J. Pol. Econ. 169 (1968); Stigler, *The Optimal Enforcement of Laws*, 78 J. Pol. Econ. 526 (1970); Polinsky & Shavell, *The Optimal Tradeoff Between the Probability and Magnitude of Fines*, 69 Am. Econ. Rev. 880 (1975).

⁶ IRC § 162(f)(1982). Although no completely consistent usage exists, fines generally result from criminal violations and penalties generally result from civil violations.

⁷ Other articles have considered the effect of taxes on the size of damage awards. See e.g., Rea, *Inflation, Taxation, and Damage Assessment*, 38 Canadian Bar Rev. 280 (1980) (focusing on appropriate adjustment of civil damages to achieve full compensation); Boland, *Income Tax Treatment of Antitrust Damages*, 22 Tax L. Rev. 47 (1966) (discussing the effect of taxes on antitrust enforcement).

generate external harm; second, we assume that it is beneficial for a firm with private benefits that exceed external costs to engage in the activity. We exclude from the discussion fines and penalties resulting from activities with no socially redeeming value.⁸ In those cases, other considerations, such as moral and ethical issues and the encouragement of voluntary transactions,⁹ outweigh concerns of economic efficiency.

The current tax treatment of fines and penalties distorts a firm's choice among inputs and increases the social costs of production. Either Congress should allow full deductibility of fines and penalties or the government should reduce the amount of fines or penalties to reflect the offender's marginal tax rate. Part I reviews the tax treatment of fines and similar penalties. We then examine considerations in setting the amount of fines or penalties. Part III examines optimal enforcement in the presence of income taxation. Finally, we conclude by describing the implications for future de-

⁸ Although our conclusions may apply to the economic consequences of disallowing deductions for expenses incurred in conducting illegal activities, we make no attempt here to consider the complications necessary to map these activities onto our analysis.

⁹ See Posner, *An Economic Theory of Criminal Law*, 85 *Colum. L. Rev.* 1193 (1975).

sign of fines and penalties. The Appendix presents a formal economic model of the analysis.

I. Tax Treatment of Fines and Similar Penalties

Section 162(f) provides that "[n]o deduction shall be allowed ... for any fine or similar penalty paid to a government for the violation of any law."¹⁰ This provision, added by the Tax Reform Act of 1969 (the "1969 Act"),¹¹ codified the results of a series of cases that disallowed deductions for amounts paid as fines or penalties on "public policy" grounds.¹²

¹⁰ Reg. § 1.162-21(b) specifies four types of fines and penalties covered by the provision: (i) amounts paid pursuant to a conviction or plea of guilty or *nolo contendere* for a crime (felony or misdemeanor) in a criminal proceedings; (ii) amounts paid as a civil penalty imposed by federal, state, or local law, including additions to tax and additional amounts and assessable penalties imposed by chapter 68 of the Internal Revenue Code of 1954; (iii) amounts paid in settlement of the taxpayer's actual or potential liability for a fine or penalty (civil or criminal); or (iv) amounts forfeited as collateral posted in connection with a proceeding which could result in the imposition of such a fine or penalty.

¹¹ Pub. L. No. 91-172, § 902(a), 83 Stat. 487 (1969).

¹² Three types of deductions were prone to disallowance on "public policy" grounds: first, amounts paid as fines and penalties to state, local or federal agencies; second, expenses incurred in conducting certain illegal activities; and third, illegal expenditures incurred in conducting legal activities. See Taggart, *Fines, Penalties, Bribes and Damage Payments and Recoveries*, 25 *Tax L. Rev.* 611 (1970); Tyler, *Disallowance of Deductions on Public Policy Grounds*, 20 *Tax L. Rev.* 663 (1969); Comment, *Business Expenses, Disallowance and Public Policy: Some Problems of Sanctioning With the Internal Revenue Code*, 72 *Yale L.J.* 108 (1962) (hereafter "Yale Comment").

Before the 1969 Act, the courts, relying on the statutory language of the Code provision providing deductions for business expenses, disallowed deductions on public policy grounds.¹³ Section 162(a) generally allows deductions for all the "ordinary" and "necessary" expenses paid or incurred in carrying on a trade or business.¹⁴ The courts, however, were convinced that allowing deductions would undermine the enforcement efforts of the various governmental units imposing fines or penalties. Courts faced two competing considerations: the pressure to measure net income accurately regardless of moral or legal considerations;¹⁵ and, a notion that allowing such deductions would frustrate public policy.¹⁶ By disallowing these deductions, the courts created an exception to the broad principle that the Federal income tax was meant as a tax on net income and not as a sanction against wrongdoing.

¹³ See, e.g., *Commissioner v. Heininger*, 320 U.S. 467 (1943); *Burroughs Building Material Co. v. Commissioner*, 47 F.2d 178 (2d Cir. 1931). Other courts found payments not necessary if there was another method of conducting operations without violating the law. See, e.g., *Hoover Motor Express Co. v. United States*, 356 U.S. 38 (1958).

¹⁴ IRC § 162(a)(1982) and predecessor IRC § 23(a)(1)(A)(1939).

¹⁵ The legislative history of the early revenue acts clearly provides for a tax on net income not gross receipts. The purpose of the acts was not to penalize or prohibit unlawful activities. See *Yale Comment*, supra note 12, at 110-12 and sources cited therein.

¹⁶ See Taggart, supra note 12, at 614-15.

The rationale underlying disallowing deductions on public policy grounds is clearly expressed in Tank Truck Rentals, Inc. v. Commissioner,¹⁷ the major Supreme Court decision addressing the deductibility of amounts paid as fines or penalties. Tank Truck Rentals involved a trucking concern that paid substantial fines resulting from violations of a state's maximum highway weight laws. In denying a tax deduction for fines paid, the Supreme Court concluded that allowing such deductions would encourage continued violations by decreasing the costs of noncompliance.¹⁸ The Court approved the holdings of earlier cases that found allowing a tax benefit reduces the impact or the sting of the penalty.¹⁹ It thus held that allowing deductions for amounts paid as fines frustrates sharply defined state policy.

Courts and Congress got part of the equation right. Disallowing deductions will, at the margin, increase the odds of compliance. They perhaps failed to fully appreciate, however,

¹⁷ 356 U.S. 30 (1958).

¹⁸ 356 U.S. at 35.

¹⁹ United States v. Jaffray, 97 F.2d 488 (8th Cir. 1938), affirmed on other grounds, sub nom., United States v. Bertelsen & Petersen Engineering Co., 306 U.S. 276 (1939); Tunnel R. Co. v. Commissioner, 61 F.2d 166 (8th Cir. 1932); Chicago, R. I. & P. R. Co. v. Commissioner, 47 F.2d 990 (7th Cir. 1931); Burroughs Building Material Co., supra note 13; Great Northern R. Co. v. Commissioner, 40 F.2d 372 (8th Cir. 1930); Davenshire, Inc. v. Commissioner, 12 T.C. 958 (1949).

that disallowing deductions increases the burden of the fine or penalty by the amount of the additional tax liability.²⁰ Disallowing deductions also has a disproportionate effect on taxpayers in different tax brackets: the higher the taxpayer's marginal tax rate, the greater the detriment. We shall return to both points.

The 1969 Act extends the policy of disallowing deductions beyond fines; it also includes "similar penalties." The legislative history distinguishes between penalties that have the same purpose as fines²¹ -- presumably, those sanctions that are punitive in nature -- and penalties that are compensatory or remedial in nature. Deductions are thus allowed for damages meant solely to compensate a party for harm suffered.²²

From the standpoint of deterrence, the distinction between compensatory and punitive damages makes little sense. The

²⁰ See Keesling, *Illegal Transactions and the Income Tax*, 5 UCLA L. Rev. 26, 36-37 (1958); Yale Comment, *supra* note 12, at 117.

²¹ S. Rep. No. 92-437 (1971), reprinted in 1972-1 C.B. 559, 600.

²² Courts have thus upheld deductions in *True v. United States*, 603 F.Supp. 1370 (D. Wyo. 1985); *Mason Dixon Lines, Inc. v. United States*, 708 F.2d 1043 (6th Cir. 1983); and *Southern Pacific Transportation Co. v. Commissioner*, 75 T.C. 497 (1980).

A similar distinction exists in the antitrust area. Firms can deduct amounts paid as compensatory damages but are not allowed to deduct the remaining two-thirds paid as treble damages under the antitrust laws. IRC § 162(g)(1982).

penalty should induce efficient behavior. It does not matter whether the offender pays compensation to a specific victim or to society at large. The tax treatment should be the same for both payments. If the fines or penalties are set at a level that reflects the harm caused, then the amounts should be fully deductible regardless of whether payments constitute direct compensation.

The current tax treatment of fines and penalties thus contains three main deficiencies. By disallowing deductions for amounts paid as fines or similar penalties, the current treatment over penalizes certain activities, creates different costs for the same offense for taxpayers in different brackets, and treats differently certain amounts paid as penalties merely because the offender pays compensation to a specific victim rather than society at large. These deficiencies likely result from a failure to consider explicitly how to design fines and penalties in the presence of taxation. We contend that efficient deterrence requires the tax system to be neutral regarding a firm's choice of inputs, and, in particular, the tax treatment of fines and penalties should not favor one input over another.

II. The Deterrence Approach

Firms²³ in conducting operations choose from a wide variety of inputs, such as expenditures for labor, raw materials, and energy. Firms maximize profits by choosing an input mix that equalizes the marginal revenue product of an additional dollar spent for each input.

Some inputs generate external harms. Absent government intervention, firms maximize profits without regard to the harm imposed on others. The government seeks to regulate the externality by requiring the firm to include the external harm in its profit calculations. The government sets uniform standards for such items as air pollution, double parking, or allowable highway truck weights based on some notion of society's total benefits and costs of the activity. Firms regulated by such standards, however, are heterogeneous in their benefits and costs. For a firm with a particularly high marginal benefit, such as Federal Express delivery service engaging in double parking, it may be socially desirable for that firm to violate the standard.

²³ The discussion applies to any enterprise, whether in the form of a sole proprietorship, partnership, or corporation, engaged in the conduct of a trade or business and whose income is subject to taxation.

To assure that violations will occur only when they are efficient, the government can require a firm to bear the cost of the externality by imposing a schedule of fines or penalties. In the simplest situation, complete enforcement and no taxation, the government should impose a fine or a penalty equal to the marginal external harm caused. Then the firm will face relative prices for the inputs that reflect their relative marginal social costs. Faced with these relative prices, each firm will choose the efficient amount of the inputs burdened with the externality.

This policy results in an efficient amount of a particular activity, even though the activity generates external harm. Because a firm will avoid engaging in an activity that yields more costs than benefits,²⁴ the amount of the fines or penalties should not be set at such a high level that socially beneficial activities are not undertaken.²⁵

III. Optimal Enforcement in the Presence of Income Taxation

²⁴ See Bentham, *An Introduction to the Principles of Morals and Legislation* 179 (1823); Becker, *supra* note 10.

²⁵ See Richard A. Posner, *Economic Analysis of Law* 207 (3rd ed. 1986).

How does a firm choose an efficient mix of inputs when the firm's income is subject to taxation and other inputs are deductible for tax purposes? For simplicity, we assume that the firm bears the entire incidence of the tax, and further, that inputs are not subject to tax preferences or detriments apart from the tax treatment of fines and penalties.²⁶

We adopt as a benchmark the efficient mix of inputs, that is the mix that would be chosen by a firm that faces relative prices for the inputs equal to the relative marginal social costs. Broadly, two possible approaches to the design of an efficient enforcement system exist: first, to disallow deductions for expenditures for fines or penalties and to adjust the amount of fines or penalties for the offender's tax rate and probability of enforcement; second, under a proportionate tax system, to allow deductions and to adjust fines or

²⁶ To the extent inputs are subject to other tax preferences or detriments, or for that matter, any other market imperfections, it may be difficult to determine whether changing the tax treatment of fines and penalties results in a firm choosing the efficient mix of inputs. See Lipsey & Lancaster, *The General Theory of Second Best*, 24 *Rev. Econ. Stud.* 11 (1956); Zelinsky, *Efficiency and Income Taxes: The Rehabilitation of Tax Incentives*, 64 *Texas L. Rev.* 973, 996-1002 (1986) (discussing the difficulty of determining whether making a noncompetitive economy more competitive improves society's optimal allocation of resources).

penalties only for the probability of enforcement. The optimal design of fines or penalties depends on the approach taken.

**A. Complete Enforcement and Proportionate
Income Taxation**

The analysis first assumes a proportionate income tax system and complete enforcement, which detects and successfully prosecutes all violations.

1. Nondeductible Fines and Penalties. Suppose the government sets the fine or penalty at a level equal to the harm caused. Under the nondeductible regime, the firm's cost of inputs not generating externalities equals the price less the benefit of the tax deduction. In contrast, the cost of the externality-generating input equals the sum of the price of the input net of the tax deduction²⁷ plus the amount of the fine or penalty without any benefit of tax deduction. The firm maximizes profits by choosing its mix of inputs on an

²⁷ For simplicity, the discussion herein and the model in the Appendix assume the private cost of the externality-causing input is zero.

after-tax basis. Because expenditures for inputs other than the input generating the externality are fully deductible, the firm chooses too little of the input generating the externality and too much of other inputs relative to the efficient mix of inputs.

Moreover, this distortion causes the firm's cost of production to be higher. Accordingly, the total market supply of the product will be lower. The distortion reduces social welfare in two ways: inefficient use of inputs, and inefficient level of production. The higher the tax rate, the greater the distortion becomes.

Suppose instead that the government adjusts the fine or penalty so that the income tax becomes neutral with respect to the firm's choice of inputs. Let F represent the amount of the fine or penalty, t represent the tax rate (assumed here to be constant), and H represent the external harm caused by the activity. Let the government set the fine or penalty according to the rule:

$$F = (1-t) H.$$

Then the after-tax cost of the externality-causing input relative to the after-tax cost of the other inputs will be identical to the relative social marginal cost of the inputs.

Since the firm faces relative input costs equal to the relative social marginal costs, the firm chooses an efficient mix of inputs. This lowers the firm's cost of production, and reduces the distortion due to reduced production. Note, however, that the income tax still drives a wedge between the amounts paid by the firm for its share of capital and amounts received by shareholders. This distortion results in a total industry output below the efficient level.²⁸

Under the nondeductible approach, the higher tax rate, the less attractive the input bearing the externality becomes relative to other inputs, the more the government should reduce the amount of the fine or penalty. Note that if entities that are not subject to taxation (for example, municipal governments and tax-exempt enterprises) use the externality-causing input, then the government should not adjust fines or penalties applicable to those entities for taxes. Similarly, if fines or penalties apply to individuals engaged in personal activities not eligible for tax deductions, then no adjustment for taxes is required.

2. Deductible Fines and Penalties. Congress could alternatively allow fines and penalties to be deductible. Un-

der this regime, all inputs into production receive the benefit of a tax deduction. Suppose that the government sets the fine or penalty equal to the harm caused, then the relative cost of inputs on an after-tax basis will be identical to the relative marginal social cost. In these circumstances, the firm will choose an efficient input mix.

Under the deductible regime, the optimal schedule of fines and penalties with taxation would be the same as the optimal schedule in the absence of taxation. In essence, with complete enforcement, the fine or penalty becomes equivalent to a Pigouvian excise tax²⁹ on use of the externality-causing input.³⁰

B. Random Enforcement and Proportionate Income Taxation

Certain activities resulting in external harm are not easy for the government to observe. Where activities are conceal-

²⁹ Pigou, *Economics of Welfare* 194 (3rd ed. 1929).

³⁰ Firms may deduct amounts paid as excise taxes as long as the costs represent ordinary and necessary expenses incurred in the conduct of a trade or business. Reg. § 1.164-2(f).

able, the amount of the fine or penalty must be adjusted for the probability of detection and successful prosecution. Complete enforcement increases the probability of detection and successful prosecution close to one. Because complete enforcement is expensive, however, society must determine the level of enforcement it can afford.³¹ One approach to enforcement may be a program of random inspection resulting in a specific probability of enforcement.

1. Nondeductible Fines and Penalties. Under the non-deductible regime, the general conclusion remains that for efficient use of inputs, the fine or penalty must be adjusted to reflect the firm's tax rate. The fine or penalty, however, must also be adjusted to account for random enforcement. Let p represent the probability of enforcement, then let the government set the fine or penalty as follows:

$$F = (1-t)/p H.$$

Under a system of random enforcement, the government must increase the amount of the fine or penalty to ensure that the

³¹ See Stigler, *supra* note 5, at 526-29.

expected after-tax cost of using the input equals the marginal social cost.³² The government should reduce the fine or penalty by a factor $(1-t)$ so that the expected after-tax cost of the externality-causing input relative to the after-tax cost of the other inputs will be identical to the relative social marginal cost of the inputs.

Some contend that the government fails to sufficiently increase fines and penalties for the probability of enforcement. Simple application of the formula may result in fine that seems unfairly high when compared to the actual harmed caused.³³ If the government fails to sufficiently increase the fine or penalty to account for random enforcement, a policy of disallowing deductions will compensate by increasing the effective amount of the fine or penalty.³⁴

2. Deductible Fines and Penalties. If Congress allows fines and penalties to be deductible, the amount of the fine or penalty need only be adjusted for random enforcement. The optimal fine becomes:

³² See Becker, *supra* note 5, at 180-85.

³³ As long as the *ex ante* chances of being apprehended are the same for all, a strong argument can be made that no unfairness results. See Posner, *supra* note 25, at 212 (discussing the fairness of a criminal justice system that creates low probabilities of apprehension and conviction when the *ex ante* costs and benefits are equalized among participants).

³⁴ A policy of disallowing deductions will, however, further distort if the the adjustment for random enforcement is too high.

$$F = 1/p H,$$

which is the fine or penalty that would be optimal in a world without taxation. Because all inputs are priced on the same after-tax basis, the firm chooses an efficient input mix and fines and penalties need not be adjusted.

The current regime of disallowing deductions for fines and similar penalties interferes with a firm choosing an efficient input mix. Assuming proportionate taxation, one can improve the situation either by making all fines and penalties not deductible, and suitably adjusting the fines and penalties for both the tax rate and the probability of enforcement, or by making all fines and penalties fully deductible and adjusting only for the probability of enforcement. Under each approach, a single common schedule of fines and penalties applies to all taxpaying firms.

C. Progressive Income Taxation

What if the tax system is progressive? The structure of a progressive tax system provides for the taxpayer's marginal rate of tax to increase as taxable income increases.

1. Nondeductible Fines and Penalties. Under the non-deductible regime, the higher the marginal tax rate, the greater the burden of the fine or penalty, the greater the distortion towards inputs that are fully deductible. Guided by the same basic intuition as in the case of proportionate taxation, let the government set the fine or penalty as follows:

$$F = (1-r)/p H,$$

where r represents the marginal tax rate at the level of income given by the efficient mix of inputs. Under this schedule of fines or penalties, the expected after-tax cost of the externality-causing input relative to the after-tax cost of the other inputs faced by the taxpaying firm will be identical to the relative social marginal cost of the inputs.

Note that to set fines or penalties correctly under a system of progressive taxation, the government must first determine the level of income that results from an efficient input mix. Once the government determines the level of income, it can use the appropriate r in setting the amount of the fine or penalty. Because firms have different efficient input mix and hence different levels of income, they will have different r . The government must therefore set the amount of

the fine or penalty after determining the r for each firm. Thus the greater diversity of technology across firms, the greater the difference in optimal fines or penalties across firms.

Tying the amount of the fine or penalty to the tax rate of the offender represents a radical departure from the current design. The proposed approach requires a lower fine or penalty before taxes for wealthier offenders (those with higher r) than for those less fortunate. In contrast, the current design results in higher after-tax costs for fines and penalties imposed on wealthier offenders than those in lower tax brackets.

2. Deductible Fines and Penalties. Under a deductible regime, the government can achieve efficient results with appropriate design, but the design of optimal fines and penalties becomes more difficult. The difficulty results because the marginal tax rate may be a function of the firm being successfully detected and prosecuted. If the government fines the firm, the firm's taxable income is reduced and its marginal tax rate may be lower. If the government does not fine the firm, then the firm's taxable income is higher and the firm may be subject to a higher marginal tax rate. The optimal fine or penalty therefore depends on the interplay between the probability of enforcement and the two marginal

brackets.³⁵ It is not simply the fine or penalty that would be optimal in a world without taxation.

With progressive taxation of income, the schedule of fines or penalties must thus be tailored to each individual firm according to its marginal tax rate. This implies that the government must set a menu of fines or penalties. Only if all firms have identical technology, and hence have identical efficient mix of inputs will they be subject to the identical schedule of fines or penalties.

IV. Implications For Future Design of Fines and Penalties

We have described three problems with the current tax treatment of fine and similar penalties. First, the tax treatment interferes with the firm's efficient choice of input mix by providing an additional cost in the form of a disallowed deduction. Firms will substitute away from inputs that result in fines or similar penalties towards inputs that

³⁵ See Appendix for details. The post-1986 Act corporate tax rate structure should reduce this complication as a 34% marginal tax rate will apply to most corporate taxpayers.

are fully deductible. The inefficient mix results in higher social costs of production, and consequently smaller output. Second, the current tax treatment discriminates among offenders according to their tax brackets. The more progressive the tax system, the greater the distortion becomes. Non-deductible fines and penalties create greater incentives for firms with higher marginal tax rates to reduce use of externality-causing inputs than firms with lower marginal tax rates. Third, the current tax treatment discriminates between the compensatory portion of a penalty and fines or penalties where the offender does not pay compensation directly to a specific victim. No economic basis for this distinction exists. We therefore contend that either Congress should allow full deductibility for amounts paid as fines or penalties or the government should reduce the amount of the fine to reflect taxes. Either approach results in an efficient use of inputs and production.

Circumstances may exist, however, where the current system closely approximates the optimal fine or penalty. A policy of nondeductibility of fines and penalties may make sense if the government improperly sets fines or penalties from either underestimating the amount of the external harm or not increasing the fine or penalty high enough to account for incomplete enforcement. If the government overestimates the amount of

external harm or increases the fine or penalty too much to account for incomplete enforcement, however, a policy of non-deductibility may aggravate the distortions on input mix.

The rate reductions in the 1986 Act significantly reduce the total costs of fines and similar penalties for certain taxpayers.³⁶ If before the 1986 Act, fines and penalties closely approximated the correct result due to under-adjustment for the probability of enforcement, then the 1986 rate changes may have caused fines and penalties to depart significantly from the efficient level. If, however, before the 1986 Act, fines and penalties were set too high because they failed to incorporate tax considerations, then the lower rates may result in a greater and more efficient use of externality-causing inputs. The empirical implications of our analysis is that the 1986 Act leads firms to increase use of inputs, such as those that result in pollution, overloading of trucks, double parking, and safety violations, as the effective after-tax costs of those inputs has been reduced relative to the costs of fully-deductible inputs.

³⁶ Whether the 1986 Act changes reduce a taxpayer's total cost of fines and penalties depends on the change in the offender's marginal tax rates. Although nominal tax rates were reduced, the 1986 Act significantly broadened the tax base for many corporate taxpayers so that changes in effective marginal tax rates are hard to predict.

The choice between allowing full deductibility and reducing the amount of the fine or penalty may depend on several factors. A policy of full deductibility may be less costly to administer, especially if the tax system is roughly proportional. It allows the same fine or penalty to apply in instances when the sanctions are imposed on tax-exempt entities and individuals engaged in personal, nondeductible activities, as well as firms engaged in a trade or business. The deductible regime also does not require the government to adjust fines and penalties whenever tax rates change, and eliminates the need to differentiate between penalties that are compensatory and other fines and similar penalties. If, however, the tax system is progressive, it may be easier to design optimal fines and penalties under a nondeductible approach, especially if firms and technology are very diverse.

Several important limitations apply to the conclusions of this Article. First, we assume it is socially beneficial for a firm with private benefits that exceed external costs to engage in an activity that generates external harm. Second, we deliberately exclude consideration of offenses with no socially redeeming value. Third, the analysis assumes that all firms are risk-neutral. This assumption may be quite plausible for publicly-held firms, but less so for firms that are sole proprietorships and small partnerships. In the lat-

ter case, the firms may be risk-averse so that the fines and penalties must be further adjusted to account for risk aversion.³⁷ Finally, we have assumed a constant probability of enforcement. In practice, the government will choose a probability that reflects a tradeoff between the marginal increase in social welfare from more enforcement and the marginal cost of enforcement.³⁸

37 See Polinsky & Shavell, *supra* note 5.

38 See Stigler, *supra* note 5.

Appendix

August 22, 1988

1 Model

Consider a total of n firms $i = 1, \dots, n$ engaged in some business that requires inputs of labor and some other input, say air pollution, that gives rise to an external harm. For each i , let ℓ_i be the quantity of labor employed, and a_i the quantity of air pollution, and $R_i(\ell_i, a_i)$ represent i 's revenue from the business with inputs ℓ_i and a_i . For simplicity, we assume that the cost of the labor input is $C_i(\ell_i)$, and that the private cost of the pollution input is zero.

Let $H(a_i)$ be the harm caused to other persons by the pollution. Then the efficient input of labor, ℓ_i^* , and the efficient level of pollution by firm i , a_i^* , maximize

$$R_i(\ell_i, a_i) - C_i(\ell_i) - H(a_i). \quad (1)$$

We assume that the function $R_i(\cdot, \cdot)$ is increasing and strictly concave in both arguments, and that the functions $C_i(\cdot)$ and $H(\cdot)$ are increasing and strictly convex.

The solution is characterized by the first-order conditions

$$\frac{\partial}{\partial \ell_i} R_i(\ell_i, a_i) - \frac{\partial}{\partial \ell_i} C_i(\ell_i) = 0, \quad (2)$$

and

$$\frac{\partial}{\partial a_i} R_i(\ell_i, a_i) - \frac{\partial}{\partial a_i} H(a_i) = 0. \quad (3)$$

Because firms have different revenue and labor cost functions, the efficient level of pollution will differ across firms.

By the very nature of harmful activity, the government may have difficulty observing each firm's a_i , hence the government's enforcement of the fines may consist of a program of random inspection. Since the government cannot observe *ex-ante* the firm's a_i , the probability of inspection, p , cannot be a function of each firm's a_i . It may be a function of the choices of the whole population, (a_1, \dots, a_n) , but for simplicity, we assume that p is a constant.

2 Proportionate Income Taxation

Our objective is to consider how the fines should be amended when the firm's income from the business is subject to taxation. In this section, we assume that the income tax is proportionate at rate t . The firm's expenditure on labor is deductible from tax. There are two possible approaches with regard to the income tax treatment of the expenditure on fines for pollution.

2.1 Nondeductible Fines

Under the first approach, Congress does not allow a deduction for expenditure on fines, hence the firm maximizes

$$(1 - t) [R_i(L_i, a_i) - C_i(L_i)] - p F_i(a_i).$$

Let $p F_i(a_i) = (1 - t) H(a_i)$, or

$$F_i(a_i) = \frac{(1 - t)}{p} H(a_i), \quad (4)$$

then the firm will maximize

$$(1 - t) [R_i(L_i, a_i) - C_i(L_i)] - (1 - t) H(a_i).$$

But this is equivalent to maximizing

$$[R_i(L_i, a_i) - C_i(L_i)] - H(a_i),$$

which is identical to (1), hence, the firm will choose the efficient labor and pollution input.

If enforcement is complete, $p = 1$, then the optimal schedule of fines is

$$F_i(a_i) = (1 - t) H(a_i).$$

2.2 Deductible Fines

The alternative approach is for Congress to allow the firm to deduct expenditure on fines. Then the firm will maximize

$$\begin{aligned} p(1-t)[R_i(l_i, a_i) - C_i(l_i) - F_i(a_i)] + (1-p)(1-t)[R_i(l_i, a_i) - C_i(l_i)] \\ = (1-t)[R_i(l_i, a_i) - C_i(l_i)] - p(1-t)F_i(a_i). \end{aligned}$$

If the government sets $p F_i(a_i) = H(a_i)$, i.e.,

$$F_i(a_i) = \frac{1}{p} H(a_i), \tag{5}$$

then the firm will maximize

$$(1-t)[R_i(l_i, a_i) - C_i(l_i) - H(a_i)],$$

which is equivalent to maximizing

$$[R_i(l_i, a_i) - C_i(l_i)] - H(a_i),$$

which is identical to (1), hence, the firm will choose the efficient labor and pollution inputs.

If enforcement is complete, the optimal fine is

$$F_i(a_i) = H(a_i),$$

i.e., a Pigouvian excise tax.

Note that provided that income taxation is proportionate, the policy that induces efficient choice of inputs is identical for all firms. This holds true under both the approaches of nondeductible fines, and of deductible fines. We see next that, under a progressive system of income tax, the efficient fine must be tailored to the individual firm according to its marginal tax rate(s).

3 Progressive Income Taxation

Let the income tax system be progressive, and in particular, let it be characterized by a increasing concave function $S(\cdot)$ such that if a firm's taxable income is Y , then its post-tax income will be given by $S(Y)$. The function $S'(Y)$ is the marginal rate of retention.

3.1 Nondeductible Fines

Each firm will maximize

$$S[R_i(\ell_i, a_i) - C_i(\ell_i)] - p F_i(a_i).$$

The first-order conditions are

$$S'[R_i(\ell_i, a_i) - C_i(\ell_i)] \cdot \left[\frac{\partial}{\partial \ell_i} R_i(\ell_i, a_i) - \frac{\partial}{\partial \ell_i} C_i(\ell_i) \right] = 0,$$

and

$$S'[R_i(\ell_i, a_i) - C_i(\ell_i)] \cdot \left[\frac{\partial}{\partial a_i} R_i(\ell_i, a_i) \right] - p \frac{\partial}{\partial a_i} F_i(a_i) = 0.$$

The first-order conditions simplify to

$$\frac{\partial}{\partial \ell_i} R_i(\ell_i, a_i) - \frac{\partial}{\partial \ell_i} C_i(\ell_i) = 0, \tag{6}$$

and

$$\frac{\partial}{\partial a_i} R_i(\ell_i, a_i) - \frac{p}{S'[R_i(\ell_i, a_i) - C_i(\ell_i)]} \frac{\partial}{\partial a_i} F_i(a_i) = 0. \tag{7}$$

Suppose that the government sets enforcement

$$\frac{p}{S'[R_i(\ell_i^*, a_i^*) - C_i(\ell_i^*)]} F_i(a_i) = H(a_i),$$

or

$$F_i(a_i) = \frac{S'[R_i(\ell_i^*, a_i^*) - C_i(\ell_i^*)]}{p} H(a_i). \quad (8)$$

Then equations (6) and (7) will be identical to (1) and (2), hence the firm will choose the efficient labor and pollution inputs. If τ be the marginal rate of tax, the optimal fine may also be expressed as

$$F_i(a_i) = \frac{1 - \tau[R_i(\ell_i^*, a_i^*) - C_i(\ell_i^*)]}{p} H(a_i). \quad (9)$$

To construct the policy, the government must first find the firm's ℓ_i^* and a_i^* , then compute the τ at the efficient input levels, and finally, substitute in (9) for the schedule of fines. In this case, each type i will face a different schedule of fines. If all firms are identical with regard to the revenue function, $R_i(\cdot, \cdot)$, and the cost function, $C_i(\cdot)$, then the schedule of fines will be identical for all firms.

3.2 Deductible Fines

Each firm will maximize

$$p S[R_i(\ell_i, a_i) - C_i(\ell_i) - F_i(a_i)] + (1 - p) S[R_i(\ell_i, a_i) - C_i(\ell_i)]. \quad (10)$$

Notice that in the event that the firm is inspected, it will be fined, hence it will fall into a lower marginal tax bracket. The lower this marginal tax bracket, the larger the proportion of the fine borne by the firm and the smaller the part borne by the income-tax authority. It is in this way that the enforcement regime—probability and fine—interacts with the income tax system. This implies that a fine of

$$F_i(a_i) = \frac{1}{p} H(a_i),$$

will not necessarily be optimal.

Because of this interaction, it is difficult to directly characterize the efficient fine under the approach of deductible fines. Instead, we show indirectly the existence of a schedule of fines, $\hat{F}_i(a_i)$, that leads the firm to an efficient choice of inputs. Let

$$G(\ell_i, a_i) \stackrel{\text{def}}{=} S[R_i(\ell_i, a_i) - C_i(\ell_i)] - p F_i(a_i), \quad (11)$$

where $F_i(\cdot)$ is given by (9). For each ℓ_i, a_i , let $\hat{F}_i(a_i)$ be such that

$$p S[R_i(\ell_i, a_i) - C_i(\ell_i) - \hat{F}_i(a_i)] + (1 - p) S[R_i(\ell_i, a_i) - C_i(\ell_i)] = G(\ell_i, a_i), \quad (12)$$

i.e.,

$$p S[R_i(\ell_i, a_i) - C_i(\ell_i) - \hat{F}_i(a_i)] = p S[R_i(\ell_i, a_i) - C_i(\ell_i)] - p F_i(a_i).$$

Since $S(\cdot)$ is strictly increasing, the inverse S^{-1} exists, hence

$$\begin{aligned} \hat{F}_i(a_i) &= R_i(\ell_i, a_i) - C_i(\ell_i) - S^{-1}\{S[R_i(\ell_i, a_i) - C_i(\ell_i)] - F_i(a_i)\} \\ &\geq R_i(\ell_i, a_i) - C_i(\ell_i) - S^{-1}\{S[R_i(\ell_i, a_i) - C_i(\ell_i)]\} \\ &= 0. \end{aligned} \quad (13)$$

Thus, $\hat{F}_i(a_i) \geq 0$ and is implicitly defined by (9) and (13).

Under the approach of deductible fines, the firm will maximize $G(\ell_i, a_i)$, as expressed in (12). By construction (equation (11)), $G(\ell_i, a_i)$ is identical to the firm's objective function under the approach of nondeductible fines. Hence, the firm will choose the same labor and pollution inputs under the two approaches.